

SPECIAL
CIPE-IRI
JOINT EDITION



**ECONOMIC REFORM
FEATURE SERVICE**

DEMOCRATIC GOVERNANCE

**The Economic Content of Democracy:
Antidote to Poverty and Terrorism**

**Building Democratic Governance and Market Reform:
Experiences of CIPE**

**Governance Issues in Transition Economies:
Current Issues in Bulgaria**

**ABCs of Political Civilization:
A Compendium of Chinese Political Reforms**



CIPE and IRI are core institutes of the National Endowment for Democracy

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Letter from the Publisher

Since its inception in 1983, CIPE has worked around the world to promote principles and ideas of democratic governance. CIPE's work is based on the idea that successful democracy building must be combined with market-oriented reforms, making the business community an integral contributor to the reform process.



The articles in this issue of the Economic Reform Feature Service focus on the issue of democratic governance—specifically, the importance of economic reforms and the role of the key institutions in the democracy building efforts.

Some developing nations continue to struggle in their efforts to build functioning democracies. In those countries governments fail to create an environment for citizen participation in the reform process. The article by George Folsom, President and CEO of the International Republican Institute, gives several examples that illustrate the impact of citizen participation in the political process. He provides success stories from Indonesia, Kenya, Afghanistan, and other developing countries. Cao Siyuan in his article "The ABCs of Political Civilization" examines the problems of the Chinese political system and recommends the separation of the Party and government by the democratic process of direct election. He calls for promoting active citizen participation in the administration and discussion of state affairs.

In his interview with CIPE, Hernando de Soto, President of the Institute for Liberty and Democracy (ILD) in Peru, presents a sound case for fighting terrorism by promoting democratic values and providing economic opportunities. The ILD was successful in defeating Peru's terrorist organization, the Shining Path, by bringing citizens into the legal system and providing them with opportunities to change the political and economic institutions in their country. The ILD's successful work focused on reforming and developing key institutions such as property law.

Establishing good governance mechanisms in developing countries remains a difficult task. Governments continue to resist basic democratic values of participation, fairness, and transparency. Some countries fail to take into account the importance of key institutions that not only help build stable political systems, but also strong markets. CIPE applauds the efforts of the organizations around the world that promote the principles of good democratic governance and work to build democratic societies and market economies. This issue of the Economic Reform Feature Service highlights success stories from around the world; for more information on CIPE's programs and its partners, I encourage you to visit CIPE's website at www.cipe.org.

A handwritten signature in black ink that reads "Willard A. Workman".

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Senior Vice President, International Affairs,
U.S. Chamber of Commerce

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Senior Vice President, International Affairs
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EDITORIAL STAFF

John D. Sullivan
Executive Director

Jean Rogers
Deputy Director, Programs

Aleksandr Shkolnikov
Communications Officer

Sarah Olsten
Program Officer, Global

The Economic Content of Democracy: Antidote to Poverty and Terrorism?

By George A. Folsom, Ph.D.

President and CEO, International Republican Institute

In the last days of the Soviet Union, the debate in Moscow raged over the sequencing of *glasnost* (opening the political system) and *perestroika* (economic reforms). When Mikhail Gorbachev chose to ease political repression ahead of the implementation of economic improvements - and the Soviet Union collapsed shortly afterward - the debate among international observers seemed to shift in the opposite direction, toward improving economic conditions before opening the political system. This was at the heart of the Asian Values argument advanced most notably by President Lee Kwan Yu of Singapore. The debate continued throughout the 1990s in countries and in classrooms around the world, with no clear winner.

After the September 11, 2001 attacks on the United States, the question of the sequencing of democratic and capitalist reforms has been recast to address international terrorism. Democracy's proponents argue that in order to reduce the recourse to violence as a means of political expression, those with grievances should be given legitimate forums and electoral processes where they can champion their ideas and have their voices heard. Those who argue for giving priority to economic reforms contend that unrelenting poverty and attendant despair among the dispossessed is a "root cause" of the resentment that fuels global terrorism.

For those who work to promote democracy and economic development, it is not as simple as choosing political or economic reform. Both types of change are necessary. Yet two perspectives have emerged on how to blend the two priorities. One view might be called "sustainable democratic development," since it relies on democracy to create grassroots, bottom-up pressure for economic policy changes and the pace of economic change will only be as fast as the public will allow. In contrast, another view might be called "internationally certified democracy" since it relies on outsiders to set forth economic benchmarks and election standards to guide societies along a path to democracy.

In many ways, this is just a more sophisticated version of the old debate over *perestroika* versus *glasnost*, but with a new twist: a clash between believers in individual empowerment of bottom-up leadership and advocates of international elites providing top-down leadership. Which direction we expect leadership to come from matters to all of us as we consider the best response to the global challenge of terrorism.

A Holistic Approach

My own perspective on this debate is influenced by the fact that I have been on both sides as a practitioner, promoting democratic development and economic reform internationally. As the

head of the International Republican Institute, a large democracy promoting NGO, I have been engaged directly with courageous democratic leaders and have seen the importance of democratic governance to building confidence with foreign and expatriate investors. Previously, as a Treasury Department official and as a private investment banker, I worked closely with foreign governments seeking to create the conditions for economic growth in order to deliver tangible benefits to voters still wary of new, democratic institutions of governance.

These experiences have led me to the conclusion that rather than debate the sequencing of political and economic reforms, it is better to take a holistic approach that combines both approaches in ways that are mutually reinforcing. In practice, the rich economic content of democracy necessitates the linkage between these approaches to reform. Simply put, political and economic reforms are two sides of the same coin, the coin of freedom.

Elections are the central rite of democratic governance, and some undemocratic regimes hold *pro forma* elections believing cynically that this will defuse foreign critics and internal opponents. In fact, sometimes this tactic is rewarded by those who are only too eager to declare that a country has joined the community of democratic nations. Investors, however,

are more difficult to satisfy. For them, a country able to conduct elections unblemished by corruption or violence is a country that is also likely to practice good governance in other areas. A government that is afraid to compete for a popular mandate or that holds an election fraught with fraud advertises not its democratic credentials, but rather its incapacity to govern well or justly - and this will tend to scare off most investors.

Several countries that are struggling economically today were once regional breadbaskets and known to be highly productive. What would countries like Zimbabwe, Cuba, Cambodia, Belarus - and even Iraq - look like with transparent, accountable governments? At IRI, we believe that all of these countries could return to, and even exceed, their former prosperity if they were to have democratic governments that guaranteed the economic freedoms of individual citizens and adhered to the rule of law.

There are also many countries struggling with political conflict today whose strife is compounded by conditions of poverty due to, *inter alia*, corruption and dysfunctional economies imprisoned by variations of the "Dutch disease." What would countries like Indonesia, Nigeria, and Venezuela look like if economic opportunities, as well as domestic and foreign investment, were able to proceed in an atmosphere free from obstacles created through civil conflicts and political crises? My experiences in other countries such as Chile and the Czech Republic suggest that democratic governance can foster conditions in which the natural wealth of countries can be connected to global markets to the benefit of their citizens.

The Role of Party Building

Bringing together political and economic reforms in a holistic framework is an intellectual challenge. Implementing reforms on both fronts simultaneously requires political leaders with a behavioral skill set with at least four components. First, there must be political leadership that is honest and committed to good governance. Second, there must be leaders skilled in communicating a realistic and yet promising vision for the country's future to an inexperienced electorate. Third, there must be courageous leadership, willing to brave the political costs of

economic reform. Add to this list the importance of astute political skills, needed to reconcile factions and forge sustainable compromises, and it becomes easier to understand why in so many cases, leadership is unable to manage both political and economic reform in an integrated fashion.

Historically, the best way to find, develop, and season political leadership is through strong political party structures. IRI is helping political parties around the world to adopt mechanisms for open and inclusive platform development. When implemented, the internal debates and votes involved in determining a party platform will explore the best ways to fit economic issues such as poverty reduction into the domestic context, balancing this important goal with other concerns to form a policy position that can then be tested in an election.

In Kenya, for example, IRI worked with a diverse group of opposition parties that identified the principal obstacle to Kenyan economic development in the corruption surrounding then-President Daniel Arap Moi and his policies of tribal favoritism. This analysis formed the basis of an electoral coalition that was able to unseat Moi's KANU party after 24 years.

Once Indonesia withdrew, the people of East Timor saw the prospect of revenue from offshore oil as their best hope for improving local economic conditions and addressing poverty. As other countries have discovered, sudden oil wealth does not help to alleviate poverty unless there is effective governance and solid institutions in place. To help East Timor's new political parties to learn from the experiences of other Asian countries, IRI sent six members of the East Timor Parliament (MPs) to Bangkok for the second International Conference of Asian Political Parties. The event marked the first opportunity for the MPs to meet their regional counterparts and learn first-hand the issues political parties in other countries face. Attendees discussed internal democracy within parties, good governance practices and regional communication and security - all critical preconditions for sustainable economic growth.

In the countries that were once part of the Soviet Union, poverty is often felt most acutely by young people

who see few economic opportunities available to them at home, and this has contributed to an increase in crime that further dims local economic hopes. Yet young people are often the most open to entrepreneurship and new economic thinking. IRI has programs in Russia, Ukraine, Georgia, Azerbaijan, and Belarus to encourage youth political participation to bring new voices and ideas into the established political parties and to give young people hope that democracy can be relevant to their economic needs and aspirations. IRI has also developed programs to encourage youth participation in Turkey, where Islamism is the main alternative to nationalism, but many young people yearn for jobs and hope and are largely alienated from the political system.

Participation in political life can be hampered when citizens feel that governments either cannot or will not address their economic and other concerns. Programs to encourage participation in the electoral process have also been a mainstay of the IRI agenda in Central and Eastern Europe, and successful Get-Out-The-Vote campaigns have been organized by IRI in countries such as Bulgaria, Georgia, Macedonia, Romania and Slovakia. In addition, IRI fosters contacts between reform minded political leaders in these countries and those in countries like Poland, Estonia, and the Czech Republic who have navigated the challenges of economic and political reforms with considerable skill.

In Venezuela and Ecuador, poverty is linked in popular opinion to discrimination against indigenous peoples as well as corrupt elites that dominate many traditional political parties and institutions. Outside pressure may help, but it requires the sustained, courageous leadership of an Enrique Bolanos in Nicaragua to reverse years of endemic corruption, a major feature in many countries where IRI operates.

In Afghanistan, political parties are an abstraction - armed warlords are a reality. IRI has sponsored the country's first, independent newspaper published in Kabul with articles in all of the local languages that report on the progress of the transitional government in restoring order and establishing basic services around the country. This has contributed to a growing culture of accountability for all of the factions, and for the

international community present in the country. It will be a long time before Afghanistan has reduced poverty nationwide, but through a free press, it will be possible for Afghans to insist that leaders act to improve conditions.

Empowering and Trusting People

Voters determine the value of policies in the electoral marketplace, and entrepreneurial politicians can experiment until they find the issue mix and priority list that works locally - in this way, democracy can work to generate anti-poverty programs.

This is because individuals with rights that are respected - the right to assemble, to speak freely, to vote in free elections - want to have governance free of corruption, a media free to inform the public of the actions and positions of competing political actors, and to have confidence in the rule of law.

The United States and its allies have spent decades admonishing governments to address the problems of corruption and the rule of law. Sadly, what we have seen is that such outside pressure is too often ignored. But when a government is democratically-elected, pressure builds *from within* as its citizens hold governments accountable for political and judicial corruption.

This is important because poverty is reduced through overall economic growth, and economic growth is most often the result of private investment, not aid from foreign governments. In a recent article,¹ Minxin Pei and Merrit Lyon show that inflows of FDI from multinationals are far more significant than foreign aid from public sector sources in the early years of the democratic experience. Pei and Lyon note that the data show that official development assistance (ODA) to new democracies has played a much smaller role in injecting fresh financial resources into those countries than has FDI. Net flows in ODA to newly democratized regimes in the three-year post-transition period in the sample were *actually negative*.

In another recent study,² this one by Richard Roll and John Talbot at UCLA, the effects of several dozen variables on per capita income were tested. The results were powerful: respect for property rights had the strongest

positive correlation with high income, while black market activity has the strongest negative correlation. Other consistently positive correlations were found with respect for political rights, press freedom, and civil liberties. It is not surprising that the high median income countries that exhibited these characteristics were all democracies.

The authors of the *Wall Street Journal - Heritage Foundation Index of Economic Freedom* have for the past eight years evaluated countries on the basis of their respective tax laws, tariff rates, business regulations, levels of government intervention in the economy, and levels of public sector corruption.³ Countries that have achieved the highest scores for economic freedom according to this index are those where poverty is less prevalent, where incomes are higher, and yes - they have democratic governments.

This is why President George W. Bush linked successful democratic reform with the success of foreign assistance to economic development when he announced the creation of a new U.S. Millennium Challenge Account at the United Nations-sponsored Financing for Development Conference in Monterrey, Mexico in March 2002, telling the world leaders assembled there:

"All people deserve governments instituted by their own consent; legal systems that spread opportunity, instead of protecting the narrow interests of the few; and economic systems that respect their ambition and reward the efforts of the people."⁴

Whether a country faces the challenge of combating poverty, or setting a course for sustainable economic growth, democratic governance is the absolute prerequisite for success. There is no better investment in a country's future success than an investment in the promotion of democratic institutions, including viable political parties.

If we make democracy work for *individuals* - all individuals, regardless of race, class, religion, ethnicity or gender - they will have the confidence and capacity to form political coalitions and parties in order to develop indigenous, national agendas through domestic debate, to address poverty and other national challenges as they see fit.

Democracy and National Security

There are those who share the belief that political and economic reforms should go hand in hand yet nonetheless contend that voters in fledgling democracies are unreliable advocates for economic reform, and must be pressured to adopt international standards - and even international agendas - in order for their societies to establish themselves as worthy members of the family of democratic nations.

Our experiences at the International Republican Institute in countries around the world lead us to the view that political and economic openings need not take place seriatim, but ought to proceed together and be mutually reinforcing. When individuals are empowered through democratic governance to pursue policies that favor their economic interests, a virtuous cycle emerges that can gradually lead to further reform, expanded liberty, and growing prosperity.

In confronting the threat of international terrorism, internationally certified standards for good governance and effective law enforcement against terrorist organizations must be combined with a sustainable model of democratic development that allows individuals to pursue their interests freely. In many ways, the latter approach will be the most important in convincing people in democratizing countries to become our allies in the war against terror - of their own free will.

(Footnotes)

1. Pei, Minxin and Merrit Lyon. "Bullish on Democracy: Research Notes on Multinationals and the Third Wave" *The National Interest*. Number 70. Winter 2002/2003.
2. Roll, Richard and John Talbot. "Why Many Developing Countries Just Aren't" Paper presented at the Center for International Private Enterprise, June 6, 2002. Available at <http://www.cipe.org/pdf/whatsnew/events/talbot.pdf>.
3. O'Driscoll, Gerald P., Kim R. Holmes and Mary Anastasia O'Grady. *2002 Index of Economic Freedom*. Co-published by The Heritage Foundation and Dow Jones & Company, 2002.
4. Bush, George W. Remarks by the President at United Nations Financing for Development Conference. Given at Monterrey, Mexico on March 22, 2002. Available at <http://www.whitehouse.gov/news/releases/2002/03/20020322-1.html>.

Building Democratic Governance and Market Reforms:

Experiences of the Center for International Private Enterprise

by John D. Sullivan, Ph.D.
Executive Director, CIPE.

This article is based on a presentation given to the “Conference on Post Cold War Initiative for Peace Building and Democracy: Enhancing the Role of Parliament and the NGOs” sponsored by The Committee to Aid Democracy for Peace Building (Japan), The Diet League to Aid Democracy for Peace Building (Japan), Yukio Ozaki Memorial Foundation (Japan), and The National Endowment for Democracy (United States) on November 13-14, 2002, in Tokyo, Japan. Additional information is available at www.cipe.org

One of the more interesting debates today is the question of democratic sequencing. That is, do countries have to meet the pre-conditions necessary to establish a liberal democratic order before holding democratic elections or can countries become liberal democracies through the process of democracy? While this may seem to be a somewhat academic issue, in reality it is now the key debate in many foreign policy issue areas. Put simply, should the international community encourage and support countries in adopting elections, constitutions, and other democratic processes no matter their level of income or history? Or should countries be encouraged to build their levels of economic development, establish property rights, build laws to protect basic human rights, and craft a sound governmental process prior to holding democratic elections. The fact

is that most countries need to build the institutions of a market economy at the same time as they develop democratic governance as these are essentially two sides of the same coin. Without a functioning market system, the process of democratic governance can't be consolidated. Likewise, without a democratic process, institutional reforms are unlikely to succeed.

In recent years, many countries have opted for the course of building a democratic government through the process of holding elections, adopting laws on press freedom, and crafting reforms in the rule of law to guarantee human rights. Yet the record of democratic consolidation is not all that promising. Of the 140 countries around the world that have been characterized as electoral democracies, less than half meet the broader test of democratic governance. That is, encouraging full

citizen participation in parliamentary processes, ensuring the rights of redress for wrongful government action, guaranteeing property rights, providing legal enforcement of contracts, and a host of other essential aspects of the day-to-day functioning of democratic systems. In short, there exists a democracy deficit that stands between the adoption of democratic political processes and the consolidation of a democratic system of government.

The Center for International Private Enterprise (CIPE), together with our partner organizations in over 80 countries, has developed a whole series of initiatives that strive to eliminate the democracy deficit. CIPE was launched in 1983 as one of the four core institutes of the National Endowment for Democracy. CIPE is also affiliated with the United States Chamber of Commerce, the world's largest business federation,

whose membership base includes over 3 million companies, individual local chambers across the United States, trade associations, and 95 American Chambers of Commerce located around the world.

Since our founding CIPE has supported over 700 projects in more than 80 countries through our programs of grants and technical assistance. In addition, we've held training programs for business associations, think tanks, and economic journalists in every region of the developing and transitional countries. We also sponsor a multi-media communications program called the Economic Reform Feature Service. Our field offices at the moment are in Russia, Romania, Bosnia, Montenegro, and Egypt.

MISSION AND GOALS

Within the world of democracy promotion foundations, CIPE's mission is unique. In general terms, we are focused on the interrelationship between democracy, free markets, and private enterprise. During the early and mid 1980s, it was often difficult to persuade decision makers and many of our fellow foundations that there was a direct and important relationship between democracy, markets, and private enterprise. Today, the relationships are much more obvious, following the collapse of communism, the Asian and Russian financial crises, and the growing importance given to subjects such as corporate governance and anti-corruption.

Dangerous Myths of Development

Despite the progress that has been made in gaining a better understanding of the complexities of building market-oriented democratic societies, there are three dangerous myths loose in the international development community that can be used to illustrate how much further we still have to go.

The first myth is the belief that once private enterprise constitutes a substantial portion of an economy, it has become a market economy. History abounds with examples of where this

has not been the case. The Philippines under Ferdinand Marcos and Indonesia under Suharto are classic examples of economies that were capitalist, based on private enterprise. But they definitely were not open-market systems. Economists call this type of behavior "rent seeking". The rest of us call it corruption and cronyism. Simply stated, the greater the degree of systemic corruption in a society, the less its economy functions on market principles, and the greater the danger to democracy.

It should be emphasized that many different types of market economies are possible, and there are real distinctions between the institutional structures in different countries. But *all market economies share a common feature: a competitive system where the rules are the same for all participants*. The key institutions include firm property rights, anti-trust regimes (or competition policy), contract enforcement through rule of law, strong corporate governance systems, and freely flowing information (transparency). Together they create the framework for a competitive market system where freedom of entry and exit are guaranteed. Furthermore, only fully functioning democratic governance system can sustain such a system over time.

The second myth is grounded in the common misconception that the business community or the private sector in general is a homogeneous monolith that either supports or opposes certain policies or leaders. This is not the case. In fact, most countries have several business communities, each with its own interests and objectives. In the economy of a single country there can be the state sector, the private sector, and the informal sector. Even within the private sector, there might be firms and entrepreneurs who work mostly in international trade, while others are engaged in producing solely for the domestic market. Clearly, these two groups will not always support the same policies. Nor will they always favor market-oriented reform.

Firms created behind protectionist trade barriers—and with strong links to and benefits from government—tend to

support the status quo. Often they also are quite anti-democratic. Conversely, firms that have been locked out of government favors, including small entrepreneurs and those engaged in international trade, are quite often the leaders behind the demand for change. Because the business communities are so diverse, it is wiser to form partnerships with business associations, think tanks, foundations, and other business organizations that have a vested interest in an open economy and a democratic political system.

The third myth is the most dangerous and is often called the market fundamentalists' view. It is the belief that markets will spontaneously emerge if government stops intervening in the economy. This is far from true. The government must underwrite and guarantee consistent, fair rules and laws so that a strong market economy may emerge. Further, government institutions and self-regulating organizations have key roles to play in ensuring that the rules are enforced. Credible, fair bank supervision is but one of the most obvious of these functions.

Without binding rules and structures that govern all players, anarchy follows. Business then becomes nothing but "casino capitalism" where investments are only bets: bets that people will keep their word and that companies will tell the truth; bets that workers will be paid; and bets that debts will be honored. Conversely, recent experience suggests that these myths could be discarded and the sterile debate between those who espouse neo-liberalism and those who attack it as misguided market fundamentals should be ended. In fact, three general observations about how democracy and markets interact should be the focus of discussion.

Democracy and the Market - Mutual Support

Contemporary history has shown that countries with democratic, market-based systems are best equipped to respond to the challenges of globalization. Specifically, there are four essential aspects of democracy that have proved to be crucial to long term economic and social development.

- A stable democratic system is the best guarantor of political stability, which is essential for long term economic growth and private sector investment.

- Democratic values such as transparency and accountability are essential for effective and responsive government and for efficient and prosperous economic activity. (The financial crises Asia and Russia experienced in the late 1990s are cases in point.)

- Sound legal and regulatory codes backed by the rule of law must exist if business is to thrive in a market economy.

- Decision making procedures that allow for participation and feedback from the private sector, civil society, labor, political parties, and other citizen groups have to be established. Without systems of feedback and accountability, governmental regulatory processes, budgeting, and other aspects of day-to-day governance lose touch with the very people and groups they were established to serve. (Examples include comment and notice periods, public hearings, and pre-publication of proposed regulations.)

While there are many issues and reforms that make up a successful democracy, countries that succeed in addressing these four central challenges also succeed in fulfilling the wishes and aspirations of their people and in creating economic opportunities essential for human growth and poverty reduction. Conversely, those that fail to establish a democratic system of governance also find that progress is halting and that they will not be able to take advantage of the many opportunities that globalization provides.

The Democratic Deficit

Market-oriented reform and democratic development are mutually reinforcing factors that can, in the best circumstances, lead to a virtuous circle of development and stability. But if that is true, why then is not to be found more often? How is it that an entire decade of reforms in Latin America are

threatened or that countries throughout Africa and the Middle East can't seem to find a way into the virtuous circle that brings citizen support for more reform?

One answer may be found in how democracy and market reforms are thought of by most Western sources of funds and by their advice to counterparts in emerging markets and developing countries. To begin, there is a long-standing consensus that democracy requires free and fair elections, motivated and informed citizens, well built political party structures, a vibrant by self-disciplined media, civil society, and (most recently) the support of the business community. Yet there is one absolutely vital missing ingredient: the day-to-day decision making processes by which a country governs democratically.

With some notable exceptions, such as Hernando De Soto,¹ most theorists and practitioners fail to take apart the black box of governance process to see how they lack democratic values of transparency, participation, fairness, and equity. Similarly, those advocating for market reforms normally fail to include political considerations or the participation of the citizens within the design of the reform program. The heavy concentration on technical experts as designers of reform fails on three levels.

First, it ignores the fact that reforms must incorporate what Dani Rodrik² calls local knowledge, and ways must be found to mandate public participation in the design of reforms. This is a process which government officials and technocrats rightly fear because it has the potential to dramatically slow down reforms. However if procedures are developed to channel this interaction at several different stages in developing the reforms, the payoffs of superior adherence to the reforms is well worth it.

The weakness in institutional development, the frequent lack of implementation, and the often poorly designed reforms constitutes a democracy deficit that threatens to reverse several decades of progress. This democracy deficit is all the

more troubling because it often goes unnoticed amongst the triumphalism that heralds a transition to democracy and the design of market-oriented reforms. To one degree or another, this democracy deficit is affecting nearly every region of the developing world.

Long thought to be a shining example of reform, Latin America has been jarred by economic crises that have led to a resurgence of populism and a broad-based skepticism about supposed 'market reforms' that were, in fact, never truly implemented. Central Europe, having seen an inspiring sea-change in the early 1990s, has been the only region to show real growth in the past year, yet the Balkans and Central Eurasia continue to beget leaders who would consolidate their power, rally nationalist fervor, and distort 'markets' for personal gain. Socialism, religious extremism, economic crises, and entrenched dictators all plague various parts of Asia. Africa faces the aforementioned problems, as well as simmering conflicts, serious lack of infrastructure, health crises, illiteracy, and an absence of market mechanisms, governance structures, and management experience to address problems effectively. The Middle East, with its own conflicts, wealth disparities, extremists, and repressive regimes, also appears near the bottom of the scale in many aspects of development.

CASE STUDY

Governance Gap - Russia (see table 1)

The gap between the passage and implementation of laws in Russia impedes small business, and entrepreneurs continue to face barriers with inspection, bribery by representatives of regulatory authorities, access to information, registration, and licensing, as illustrated in the Centre for Economic and Financial Research (CEFIR) and the World Bank chart below. However, civil society groups and the business community are increasingly involved in advocacy efforts to minimize this governance gap. In 2002, CIPE sponsored a series of roundtables in St. Petersburg, Ryazan, Kazan, and Kaluga to draw attention to and address the barriers small businesses

face and to provide a forum where local business communities could raise these issues with representatives of the local governments. Local chambers then led advocacy efforts pushing for administrative and legislative changes necessary to create a better environment for small business, resulting in:

- Issuance of a Registers of Inspections by two local governments to small enterprises, requiring government inspectors to sign in, minimizing the number of “unofficial” inspections. As a result, local governments are currently providing a Register book to every small business.

- Establishment of a Business Center for Small Enterprise by three local governments in response to the business communities’ demands for more access to information specifically relevant to small enterprises.

- Creation of a local Expert Commission for solving disputes between businesses and authorities. To date, this Commission has heard three disputes between the City Administration and local small businesses. All three were resolved in favor of the businesses.

In other efforts to decrease the governance gap in Russia, CIPE, with support from USAID, is working with the Chamber of Commerce and Industry of the Russian Federation (RCCI) and the Union of Business Associations of Russia (OPORA) to strengthen the local business associations’ ability to advocate for improvements in and implementation of administrative policies affecting small- and medium-sized enterprises in the Russian Federation.

METHODS AND APPROACHES

There are many different approaches to these issues that have been developed over the years by the National Endowment for Democracy, the German Foundations, and others engaged in assisting with the development of democratic systems. All of us share one common orientation: that we offer support and assistance to the indigenous private groups in the

Table 1
RUSSIA - THE REALITY GAP

Activity	Legal Mandate	Reality (Average/Mean)
Registering Business	5 days	26-29 Days
Registration Cost	2,000 Rubles	4,692 Rubles
Number of Offices Required to Visit	One	Three
Licensing Costs	Not to exceed 1,000 Rubles	16,600 Rubles

Source: CEFIR and World Bank, Summer, 2002

developing world that are leading the way in their countries. In the case of CIPE, our partner organizations include private business associations, policy research institutes (think tanks), private foundations, and occasionally educational institutions. Potential partner organizations are chosen carefully to ensure that they represent the private sector and the views of those seeking an open, democratic market economy. Further CIPE grants and assistance are normally limited to no more than 35 to 50 percent of an organizations operating budget and we also require matching funds of at least 25 percent. These policies are intended to demonstrate that there is local support for the project proposal.

Since the early 1980s, CIPE’s overall goal of supporting the development of market-oriented democratic systems has focused on four objectives designed to:

- Promote development of legal and institutional structures necessary to establish and maintain market-oriented, democratic societies.
- Support freedom of association for private, voluntary business groups and think tanks in order to increase the business community’s participation in democratic governance.
- Increase support for and understanding of the rights, freedoms, and obligations essential in a democratic private enterprise system among policymakers and the public.

- Implement programs that enhance business knowledge and strengthen the entrepreneurial culture of the private sector.

The major area of assistance is in the design and financial support we provide to our partner organizations in seeking to advance market-oriented reforms and improvements in democratic governance. CIPE can be grouped under the following themes.

1. *Making the case* for democratic, market-oriented reform through communications and advocacy programs in multiple languages. Such programs include increased use of the Internet and journalism education and increased efforts to reach international organizations. One common theme has been the need to reform governance systems to create more transparency, accountability, and fairness - key democratic values.
2. *Creating opportunity* through programs that offer entrepreneurship education, develop association leadership and services, and provide leadership development for women. Projects that lower barriers to entrepreneurship and address the needs of the informal sector are especially important.
3. *Combating corruption and promoting transparency* through programs that promote good corporate governance, foster democratic institutions, and enhance the rule of law.

4. *Advocating economic policy reform* by supporting development of National Business Agendas, economic policy dialogues, and in-depth analyses of specific issues such as privatization or tax reform. Such projects seek to mobilize the broad base of the private sector to become more involved in democratic processes, advocate reform, and build coalitions to advance the national interest.

CASE STUDIES

The following section provides a few mini-case studies of successful projects, which are used as training tools and guides for reform efforts in other countries.

Combating Corruption - Serbia

The Center for Liberal Democratic Studies (CLDS) is addressing institutionalized corruption in Yugoslavia and has completed a survey of the Serbian business community about this problem. This survey not only presents a concise picture of the current situation, but also explores the consequences and devastating effects of corruption on society. The survey found that bribery is a regular phenomenon for 53 percent of all businessmen and that there is common prior knowledge as to the amount of bribes paid/received for certain "favours". In addition, CLDS found that 26 percent of total business income was being spent on bribes, and as much as 35 percent of executives' working hours were spent on bribing activities. The publication and wide distribution of this analysis to both domestic policymakers and international organizations active in Serbia is having a strong impact on policy development to address the problem of corruption. Some of the concrete results to which the project contributed in partnership with the government and others include:

- The Government has established an Anti-corruption Council. This is an advisory body consisting of independent people. The activities of the body, although somewhat controversial, produced substantial impact on public opinion and some pressure on the Government.

- The Government has established anti-corruption inter-ministerial teams. These teams (ministries of police, justice, and finance) investigated corruption cases in the public sector, mostly health and education service. About 600 cases have been brought to justice.

- Government procedures have become more transparent. For example, new legislation on public procurements has been adopted and a new Customs Administration Act has been prepared and is pending in the Serbian Parliament.

- CLDS's report on Corruption in the Customs Administration is now used in training courses for customs officials.

- Trade Unions have made combating corruption in the Customs Administration one of their priorities following their participation in CLDS' national conference.

Corporate Governance and Transparency - Colombia

Improving corporate governance is a key part of Colombia's efforts to bolster its weakened democracy by combating corruption and strengthening the rule of law. Confecámaras (the Colombian Confederation of Chambers of Commerce) in partnership with CIPE has developed a legal advocacy program to strengthen corporate governance laws and regulations in Colombia. They have secured stronger corporate governance codes within newly passed labor laws regarding compensation and they have drafted new capital markets legislation in partnership with the Colombian Securities and Exchange Commission that will strengthen protection for minority shareholders, strengthen the role of independent directors on corporate boards and address conflict of interest issues. This legislation will be presented to the national congress in July.

Confecámaras has also placed a strong emphasis on educating policy makers, business people, and academics on sound principles of corporate governance and on engaging them to formulate a Declaration of Corporate Governance Principles for Colombian organizations. This document is helping to establish a

standard of ethical business practices in Colombia. The response of the private sector to this effort has been dramatic: over 60 Colombian companies have requested assistance in drafting stronger corporate governance procedures within their firms. Now in the second year of the project, Confecámaras is building the foundation of a directors training program and strengthening its education and training efforts for the media.

Curbing Corruption - Colombia

The Confederation of Colombian Chambers of Commerce (Confecámaras) and CIPE have worked together to pioneer a project entitled *Probidad*, designed to reduce and prevent corruption at the local level. This program unites the business community in an effort to improve transparency and accountability in the public procurement of goods and services. The success of *Probidad* can be seen in the level of confidence that has been established between public and private sectors in their business transactions. Confecámaras was able to modify the Procurement Law by helping local business associations publish and distribute the draft legislation and solicit comments from them.

President Alvaro Uribe of Colombia is also using many of the Confecámaras recommendations in his anticorruption initiatives and to formulate his Executive Decree, which establishes new standards for government procurement. These include:

- Mandatory publicizing of the terms of reference for public bids.
- Public hearings and review of qualified bids according to the established terms of reference.
- Oversight of the procurement process by civil society groups.
- Development of a website to make the procurement process more transparent.

National Business Agenda - Uzbekistan

The Tashkent Business Club (TBC) in Uzbekistan organized a roundtable discussion with the business community

to develop a National Business Agenda for small- and medium-sized enterprises. This Agenda addressed the key concerns of the business community including barriers to market entry, the quality of governmental services, double taxation, and the conditions of the banking system.

Since presenting the Agenda to a number of governmental officials, TBC has secured a number of new decrees and changes in law including some initial tax reform measures, the beginnings of regulatory relief and lowering of market barriers, and improved conditions for the informal sector. The Business Club is continuing their advocacy efforts with local media by publishing case studies on the problems of family firms and by working with local TV, radio, and print media.

Building the Base of Business Knowledge - China

CIPE has been sponsoring the independent China Center for Economic Research (CCER) in Beijing since 1999 in its efforts to expand and improve the quality of its electronic economics information network (CENET), by developing new sections and new material to be added, connecting more universities, and attracting more users to access the network, particularly young economists and economics students. The CENET website now receives more than 3,000 hits daily, up from 750 in 1999. CCER is also laying the groundwork for a private association for Chinese economists, with the mission of promoting academic freedom and more open debate over policymaking in China. It would be the first voluntary association of this kind in China.

The Informal Sector and Property Rights - Institute for Liberty and Democracy

CIPE has been a long time supporter and partner of Hernando de Soto's work in looking at the causes and solutions for the vast informal sectors that exist outside of the formal-legal economies. As is now widely acknowledged, de Soto's Institute for Liberty and Democracy (ILD) has changed the terms

of debate on the issue. Further, by demonstrating that much of the cause of this extra-legal sector is the sheer impossibility of conforming to the maze of duplicative rules and regulations generated in most developing countries, de Soto also developed a very practical series of reform measures. These included administrative simplification programs, the creation of simplified business registries, innovative ways of granting and guaranteeing land title, and many others. These programs are described in detail on CIPE's website at www.cipe.org or at www.ild.org.pe.

Supporting the Informal Sector - Senegal

A large informal sector weakens democracy, hinders necessary reforms and excludes millions of citizens from the political and economic system of a country. In Senegal, the Union Nationale des Commerçants et Industriels du Senegal (UNACOIS) is the largest business association with 100,000 members from shopkeepers and petty traders to small-scale industrialists, 70 percent of whom operate in the informal sector. UNACOIS is working to educate its members on fiscal, economic, and regulatory issues that present barriers to business and keep many small enterprises from entering the formal economy. UNACOIS is also publishing brief papers on customs duties and regulations, general tax code, the code governing small business, and basic information on starting and running a formal small business. In addition to providing its members with information that may otherwise be too technical or complex, UNACOIS is implementing a new communications strategy to take their members' concerns to government officials, improving the flow of information between the public and private sectors as a first step towards a more hospitable business environment.

Democratic Governance and Institutional Reform - Georgia

One of the most important pieces of legislation passed by the Georgian Parliament in its reform efforts is the Administrative Code. Unfortunately, implementation of the Code has been neither swift nor effective. The Partnership for Social Initiative (PSI)

conducted a nationwide analysis of public perceptions and understanding of the provisions of the Code and found that 24 percent of business owners had no knowledge of it at all. PSI also found that government agencies do not follow many of the Code's requirements, particularly the Freedom of Information sections. To address this lack of implementation, PSI launched a major initiative to educate businesses and the public about their rights to receive information from government agencies. PSI mobilized a coalition of 70 stakeholders to monitor the implementation of the Code through seminars, television appearances, advocacy efforts, and newspaper articles. In addition, PSI developed a model for accrediting business associations in order to provide each government agency with a list of civil society organizations with specific interests/expertise that could be consulted on key policy and regulatory issues. This process is establishing a productive private-public dialogue and is ensuring transparency in decision-making.

Promoting Democratic Governance

The experiences of the 1980s and 1990s, as well as recent crises across the globe, demonstrate that failure to incorporate democratic governance as part and parcel of political and economic reforms seriously jeopardizes the entire reform agenda and has led to populism, socialism and even terrorism in some countries. In response, CIPE has launched a democratic governance project that will unpack the concept of democratic governance conceptually and programmatically. In a primer and a policy guidebook, CIPE will break down democratic governance into a set of key institutions and essential policy practices. These publications will feature case studies and project examples that will provide business associations, think tanks and other civil society groups with a road map on how to institute democratic governance programmatically and thus address the democracy deficit. Excerpts from the guidebook will be published and distributed through CIPE's Economic Reform Feature Service. This project will also develop a training module on

democratic governance for think tanks. For more information, please email: cipe@cipe.org.

Leadership Development for Women Entrepreneurs - Africa

African businesswomen contribute significantly to the growing economies of their countries, but not enough of them are ascending to leadership positions from which they can promote economic and democratic reform. In order to promote the inclusion of African women in the process of democratization, CIPE is providing a comprehensive leadership program for African businesswomen. This training includes strategic planning, communication techniques, advocacy, and the role of leadership (particularly women's leadership) in community development.

Entrepreneurship Education - Egypt

Through our regional office in Cairo, CIPE has brought together over 200 university students as part of its entrepreneurship education program to consider the core ideas of a market economy including self initiative, risk taking, creativity, rule of law, transparency, and accountability. Students were taught how to develop the full range of elements in a business plan (description of the business, marketing plan, management plan, and financial plan). The issue of competitiveness was highlighted through the marketing plan template. A financial template was also designed to guide students to develop an income projection statement, a balance sheet, and a monthly cash flow projection. Students are paired with young business professionals to provide further mentoring and training through an internship program. CIPE's partner, the Egyptian Junior Businessmen Association, also helped to show the students that anybody with a good idea and the determination to market and sell that idea is an entrepreneur.

The education initiatives are coupled with a communication program where a series of monthly workshops are held on specific topics to further reach out to the youth. The monthly workshops engage the youth in understanding what being an entrepreneur means

and also provide them with skills to be able to express their views. Now under development, CIPE's Arabic website for the youth will provide a platform for the participants to express their opinions in an electronic journal. The website will be a venue for the expression of the views of youth regarding political, economic, and social reform through the establishment of an electronic e-journal. The e-journal will be written by Egyptian youth and moderated through Junior Business Forum, Faculty of Economics and Political Science, Cairo University and the Ahram Regional Press Institute which will provide guidance on communication and distribution. The monthly workshop series for students are on topics such as the role of an entrepreneur in society, institutions needed for a properly functioning market economy, entrepreneurial challenges and how to overcome them, etc. As part of the program, CIPE is also organizing a series of writing workshops for the program participants to improve their abilities to express their views. The products from the writing workshops will be disseminated through CIPE's entrepreneurship website.

Advocacy Academy - Romania

The Establishment of the Romanian Academy for Advocacy sent a clear message to policymakers that private enterprise would have a voice in helping to set public policy on economic and democratic reform issues. The concept of the Academy is based on successful programs used in democratic countries around the world, which were integrated into building a uniquely Romanian model for advocacy by local business leaders. CIPE expert advisors provided technical assistance throughout each critical strategic phase, and dozens of Romanian executives have received intensive instruction in advocacy technology from CIPE's Expert Volunteer Consultants and corporate government affairs specialists. More than one hundred and thirty business leaders took part in high-level policy meetings with elected officials in Bucharest to press the legislative proposals of the business community. These coalitions can now lay claim to several policy successes in the Parliament and Executive branch.

CONCLUSIONS AND LESSONS LEARNED

Democracy is not inevitable. People of courage who strive for reform in their countries must seek it. All of our activities and all of our projects operate with the goal of building the institutions of democracy for the future. It is vital, moreover, to keep in mind that building strong local partnerships and providing support for those who are genuinely committed to democratic values is the key to effecting reform in closed societies as well as consolidating democracy in countries where reform is already underway. An integral factor in accomplishing these objectives is to explicitly build greater understanding of democratic governance and its link to the functioning of the market system.

The challenge of globalization has created yet another set of issues that have to be addressed by the international democracy foundations. While the effects of globalization can be debated, it is clear that this process of integrating the world economy and the world communication system is advancing rapidly despite the occasional setback. The developing countries, whether they are closed societies or developing democracies, do not have the luxury of seeking to isolate themselves from the process of globalization. Yet, they are often very unprepared to meet the challenges globalization poses.

Recently a backlash has been building that equates the process of globalization with the dictates of the so-called "Washington Consensus". In its simplest form the Washington Consensus was a set of policy prescriptions that are associated with the International Monetary Fund, the World Bank, and other development institutions. These policy prescriptions called for lowered trade barriers, balanced budgets, and other fiscal reforms; privatization; and other economic policy changes. Generally speaking, most economists and policy makers realize that the Washington Consensus was far too limited in its view of the world. In the 2002 World Development Report, *Building Institutions for Markets*, the World Bank recognizes that the key role

of institutions--such as property rights, equal access to justice, civil liberties, freedom of information, and a host of other institutions--was not understood or appreciated. Yet the development institutions have stopped short of specifically recognizing that democratic governance and democracy must be seen as the value system that creates and sustains these institutions.

International democracy foundations have a special role to play in working with and supporting the emerging markets and developing democracies to build the self-reinforcing sets of democratic institutions that both create and sustain economic growth and market economies. Often one hears that countries like Indonesia under President Suharto are proof that markets function well under authoritarian regimes. Our view is different. Countries where crony systems perpetuate monopolies, where insider-deals are exempt from the rule of law, where the day-to-day governance of the country is conducted behind closed doors, and where corruption thrives, cannot be seen as market systems. The existence of large informal sectors or underground economies is prima facie evidence that large portions of the population are locked out of the system and denied access to the rule of law. More importantly, it means that from 30 to 50 percent of the population is also locked out as the country integrates into the global system. This generates large-scale tensions and poses an ongoing threat to the entire society, rich and poor alike.

What is now clear is that the processes of globalization means that developing countries have to build the institutions that allow all of their people to benefit from economic growth and participation. Democratic institutions and the process of democratic governance are an integral part of the overall development of a society. Building these institutions and the values that sustain them is the mandate we have been given.

(Footnotes)

¹ Hernando de Soto, *The Mystery of Capital*, Basic Books, 2002. See the interview with Mr. De Soto in CIPE's Overseas Report available at www.cipe.org.

² Dani Rodrik, "Institutions for High Quality Growth", IMF, 2000 available at Dani Rodrik's home page located at www.ksg.harvard.edu/rodrik.



IRI is a nonprofit, nonpartisan organization dedicated to advancing democracy worldwide. IRI monitors elections in emerging democracies and supports institutions of political freedom and good governance in over 50 countries. IRI's programs including training on civic responsibility and the legislative process, political communications, assistance for building political parties and election campaigns, and politically energizing women and youth. Founded in 1983, IRI is funded through federal grants, as well as private contributions from individuals, corporations and foundations.



The Center for International Private Enterprise is an affiliate of the U.S. Chamber of Commerce, established in 1983 to promote private enterprise and market-oriented reform worldwide. As a principal participant in the National Endowment for Democracy, CIPE supports strategies and techniques that address market-based democratic development. CIPE also receives support from the U.S. Agency for International Development (USAID), as well as private corporations and foundations. Since its inception, CIPE has funded more than 700 projects in 80 countries and has conducted business association management training programs in Africa, Asia, Central and Eastern Europe, Eurasia, Latin America, and the Middle East.

CENTER FOR INTERNATIONAL PRIVATE ENTERPRISE

The Madison Office Building
1155 15th Street, NW Suite 700
Washington, DC 20005

Phone: (202) 721 - 9200
Fax: (202) 721 - 9250
cipe@cipe.org
www.cipe.org

Combating Corruption in Nicaragua: The Problem of Corrupt Democrats

by Enrique Bolanos Geyer,
President of Nicaragua.

This article is a transcript of a speech delivered by President Bolanos at the U.S. Department of State on February 25, 2003, where he was awarded the Democracy Service Medal by the National Endowment for Democracy. Prior to serving as Vice-President and President of Nicaragua, Enrique Bolanos headed the Superior Council of Private Enterprise (COSEP), an umbrella organization of Nicaragua's private sector and a CIPE partner. COSEP worked courageously to promote the ideals of liberty, democracy, free enterprise, protection of private property, human rights, and political and economic pluralism, challenging both authoritarian and Marxist regimes.

Democracy has few more formidable enemies than corrupt democrats. Since the end of the Cold war, and the first free elections in Nicaragua beginning a democratic process 13 years ago today, democracy as a form of government has spread to more places on earth than ever before. However, in many of these new or restored democracies, the promise of prosperity associated with a democratic form of Government has not been fulfilled. And, in these shortcomings, few bear more responsibility than corrupt democrats!

Corrupt democrats are politicians affiliated to democratic parties who have been duly elected or appointed to a position in a democratic administration, who then turn around and rob the poor, stealing the people's money. Nothing discredits democracy as a form of government faster in the eyes of the governed than to witness government officials stealing from the poor with impunity. So, in new democracy or restored democracy after another, free elections after free elections have been held with

disappointingly little improvement in the lives of everyday people. Too often, the primary reason for this state of affairs is that democratic leaders are either involved in corruption themselves or tolerate corruption, because they are afraid to pay the political costs of tackling this timeless scourge.

Indeed, corruption is difficult to defeat. In nations with a culture for impunity there are significant risks for any leader who dares to say: ENOUGH! Corruption has a constituency of powerful beneficiaries. These beneficiaries have no concern for democracy and take no pity on their fellow citizens who are living under the poverty line. They are thus contributing, with their greed and arrogance, to undermining the nation's faith in democracy. Furthermore, these powerful enemies of democracy flourish under a culture of impunity such as the one we had Nicaragua for so long.

When I became President, a little over a year ago, I knew that if Nicaragua were to advance into the XXI century, if democracy was to take root, the

rule of law had to become deep-seated. Soon after I was elected, some people advised me not to pursue transparency during the first year in my administration. They warned me that, in spite of my having been elected with 54% of the popular vote (and over 93% of registered voters went to the polls in Nicaragua during this election), my Administration was weak in the National Assembly, where we could count on the votes of maybe nine out of ninety two members.

Many urged caution, that we should "save our strength for later", they warned us that our fragile institutions would not be "up to the task". Later I found, to my chagrin, that my predecessor and running mate of 1996 was deeply and grossly involved in dreadful acts of corruption. I ought not, I would not renege on my campaign promise, and I could not in essence balk on my deeply held and long cherished value, that "no one would be above the law; neither then President Aleman, nor Vice-President Rizo, nor former president Ortega, nor myself, nor anyone else". I tried to start a light at

the end of the tunnel for hope, to shine through to those who despair in hunger and disease.

Therefore, I want to tell you today about some of the lessons I have learned. There is only one right time for there president of a democratic nation to fight corruption, and that is: always! Starting from the inaugural speech, I charged forward and put my faith in God the Nicaraguan people. Yes, we had faith, we knew that against all odds we would win this battle to begin to put an end to Nicaragua's well entrenched culture of impunity. Fourteen months later, I can tell you that our faith has paid off. Granted, I am not saying we have solved the quandary of government corruption in Nicaragua, far from it. That is still an ongoing war. We still have a tremendous amount of work to do; there are important battles to be fought, for instance, in taking party politics out of the Supreme Court rulings, the Electoral College (a permanent 5 man structure in Nicaragua), the Comptroller General (another 5 man structure) and the assembly itself where congress-people are elected by party slates rather than through face-off elections.

However, I can say this: We have broken the culture of impunity in Nicaragua. We have shown our people that the rule of law in a democracy applies equally to the rich and powerful as to the poor and dispossessed. We have shown that no matter how powerful the position you hold - up to the highest position in the land, if you steal from the people you will face justice. *The Economist* [Magazine] of last week, when talking about corruption in Central America reads: "some governments are trying to answer that. Nicaragua has charged former president Arnoldo Aleman, and several associated, with corruption. That has carried a cost: Mr. Alemans's supporters in Congress have held up several governments' reforms in retaliation."

I will not purport that the first year of my Administration has been easy. I have shared private moments of personal anguish with my wife Lila T. and some of my closest collaborators. I have lost some of my friends; I even lost my party who is now in opposition. The correct path is difficult, but it must be pursued. For that reason, it

is especially gratifying to receive, on behalf of the people of Nicaragua who supported me throughout this struggle, the Democracy Service Medal presented to me by the National Endowment for Democracy. The honor you have granted upon me makes me redouble the pledge I made during the campaign, "that I would be serving my people, rather than using my people to serve myself."

I said before that I had learned some lessons. Here is a sampling:

1. To establish the rule of law, one must remain within the law. Machiavelli was wrong: the end does not justify the means. You cannot break the law or ignore constitutional precepts in order to triumph over the forces of corruption. You cannot bribe a congressman or buy his or her vote in order to impeach a corrupt official for you may become tainted with corruption as well.

The impeaching vote on 10th of December was arranged by appealing to the conscience of an honest man who thought "he had to do the proper thing." He became vote number 47, the magic number needed for impeachment.

2. The second lesson I will share with you is: do not try to fight this grand battle alone. To win this battle, a democratically elected government must ally itself with civil society and with like-minded governments

In Nicaragua, the support of civil society has been critical to our success. The government has worked with vibrant and dynamic NGO's such as *Conciencia Nacional* and *Etica y Transparencia* (local chapter of Transparency International) and others to rally popular support behind the anti-corruption campaign. It has also relied on the analysis and advice provided by the National Social and Economic Planning Council, a consultative body established by constitutional mandate.

Another key element in our ongoing struggle is the moral, and sometimes, economic support received "dripping in" rather than "flowing in" from other democratic nations: Taiwan, Japan, the European Union, Norway, Canada, Switzerland and the United States. Let

me make a moment to say a word of thanks for the moral support received from the United States throughout this ordeal. There are men and women standing in this room today, officials of the State Department, the National Security Council, the Treasury Department, HUD, and from the US Congress who have and are providing my government with unstinting moral support. There are men and women who have recognized our struggle, the have made it America's fight, the have made it democracy's fight.

Nevertheless, the eyes of the continent, I may even venture to say, the eyes of the world are still turned to this unfinished struggle. If we fail, transparency in the world would be set back, those leaders in the future, contemplating the task ahead would think it worthless. There are too many dangers, too many doubts too many hesitations, it is a lonely path. For if it is true that man doesn't live by bread alone, it is also true that man does not live without bread! We have faith democracy will find a way to save democracy, but time may be running out.

What are we doing to replace the culture of impunity with a culture of transparency and service, will pay in the medium-term allowing economic growth to take place by reassuring investors about the business environment they will find when they take the risk of going to Nicaragua. However, the results of corruption in the 80's, the results of more recent corruption and the demands by our US friends regarding outstanding property issues have combined to create an asphyxiating internal debt that threatens to put out the light at the end of the tunnel.

Let us act together to make sure that doesn't happen.

God Bless the United States of America, God Bless each and every one of you, and God Bless Nicaragua.

The ABCs of Political Civilization: A Compendium of Chinese Political Reforms

by Cao Siyuan

Cao Siyuan is the director of the private Beijing Siyuan Merger & Bankruptcy Consultancy, Inc., and is widely recognized as the leading proponent of political reform and privatization in China by both Chinese and Western media. He has delivered speeches and published countless articles in China espousing politically sensitive opinions such as amending the Constitution to protect private property rights, opening the National People's Congress to public scrutiny and allowing freedom of the press. This article summarizes the key issues in his new book, The ABC's of Political Civilization, which was published in January 2003 by Cozygraphics in the United States

In today's China, everyone from the authorities to the common people share the same views on two points. The first point is that, in the twenty-plus years of reform and opening, China has for the first time established an economic system oriented toward market transition, and material civilization has developed on a significant scale. The second point is that a matching political system oriented toward democratization is very far from being able to emerge, and the lagging political system has already proven to be a serious impediment to economic, social, and cultural development.

The Chinese Communist Party acknowledged this fact when the concept of political civilization was introduced into the documents of the 16th Party Congress in November 2002. I define political civilization as civilized political ideas, a civilized political system, and civilized political conduct, all contributing to five essential aspects of reform: the sovereignty of the people, separation of powers, parliamentary democracy, election of the President by the people, and separation of the Party and Government.

I believe that reform of the political system is imminent, that it is not optional and cannot come slowly. If we agree that there is a need for political civilization then the current system must be uncivilized and a slow reform process simply becomes an argument to remain barbaric longer. In practice, if the current political system is not reformed into a civilized political system, it is entirely possible that tragedies like the Cultural Revolution will happen again. Today, the sword of Damocles can fall on the head of any individual in China at any time.

If political reforms do not occur in a timely manner to accelerate the movement towards political civilization, the problem of corruption will remain and the positive results of more than twenty years of reform will be forfeited to public anger and resentment. There is no use talking of social stability, of social development, or of the comprehensive development of a well-to-do society, without political reforms.

In a civilized political society the people are sovereign and any power officials may have is vested in them by the people. Citizens confer part of their power to the state for the state

to act as the citizens' public servant, to perform functions that ordinary people cannot, such as national defense, etc. The public servant can exercise only as much power as the citizens confer on him.

Once citizens have conferred the legislative power, executive power and judiciary power to the appropriate state institutions, only then do these institutions/agencies wield power. The most important characteristics of these three branches of power are, first, that they are conferred by citizens and vested in public servants, and second, that they check and balance each other and cannot be held concurrently, which is referred to as the "separation of powers."

I believe, rather, that there are four powers that must be separated. The first three are the legislative, executive and judiciary branches, or the three "official powers." The fourth power is that of society's "public opinion." The common people have never vested their power of public opinion into any state "authority." Thus, apart from engaging in propaganda abroad on behalf of the state, public servants have no right to own or control the media or public



opinion. A society's power of public opinion quintessentially belongs to the people!

The principle of a free press existing as a fourth power is based on two important premises. One is an economic belief in privatization, and the other is that political civilization must fairly balance divergent interests.

The feasibility of establishing a parliamentary democracy in China is quite real and, in fact, the National People's Congress has already become an embryonic parliamentary democracy. However, I also believe further separation of powers can be achieved by transforming China's People's Political Consultative Conference into a kind of senate.

The basic problem in the Chinese political system is the long-standing lack of separation between the Party and Government. The ruling party has traditionally controlled everything in state and society, such that it has been impossible to check and balance official power. Since the 1980s, the Chinese Communist Party also has become aware of the problem, and on many occasions has suggested reforming the party and state leadership structure to separate the Party and government.

Despite this, separation never happened. The current Chinese Constitution stipulates that the Premier

is accountable to the National People's Congress, but at the same time must also be accountable to the Politburo of the Central Committee of the Chinese Communist Party. How then can the Party and Government be separated?

I recommend that the separation of the Party and government be solved by granting the president the most important source of legitimacy: direct election by the people. It is also possible to conduct indirect elections following the selection of candidates by political parties. A president of the People's Republic of China elected through such a process would have legitimacy independent of the national legislative body. He would be able to ensure the separation, checking, and balancing of the nation's executive, legislative, and judiciary powers, and be responsible only to voters and not the Politburo.

Such a president would be both the head of state and the head of government, with the power of ultimate decision on executive matters and related appointments. The president would also be the commander-in-chief and have supreme command authority over the nation's armed forces. The president would nominate the cabinet, and appoint the Premier and members of the national military commission, subject to the approval of the National People's Congress.

If this type of presidential system is to be implemented, the current Chinese Constitution will certainly have to be amended. First it must clearly specify the scope of the president's responsibilities and rights, and second, it must grant the the National People's Congress the power to impeach the president, while giving the president no right to dissolve the People's Congress. In this manner, voters control the term of office, and can exercise removal of the president through the the national legislative body. Under this system, although the president has real authority presidential powers are not unlimited and a president cannot turn into the Qin Shi Huang¹ of ancient China or the Mao Zedong of modern Chinese history.

With consideration to a transitional period, the National People's Congress

could elect the first president of the People's Republic of China from two candidates nominated by the ruling party, and have the same term of office as the People's Congress. But, starting with the second presidency, direct election by the people would be fully implemented. The president of the state could not concurrently hold a leading position in the ruling party or serve more than two consecutive terms.

The ruling party should not be directly involved in national legislative, executive or judiciary affairs. Rather, it should promote its ideas and opinions by constitutional and lawful methods. This is a paramount characteristic of modern political civilization. In order to establish a parliamentary democracy in China, apart from reforming the system of people's deputies, I suggest two basic processes of political reform: one is amending the Constitution; the other is reforming the very institution of the Chinese Communist Party.

The Constitution's three basic provisions--the absolute supremacy of citizens' rights, the provision guaranteeing the implementation of the Constitution, and the principle of transparency--should be enhanced with new amendments establishing that the private property of citizens and public property are equally sacred and cannot be encroached upon.

I recommend five key reforms in the book:

- First, re-write the general principles of the Chinese Communist Party to read, "The Chinese Communist Party works in the interest of the entire people. Proceeding from the prerequisites of the supremacy of citizens' rights and the sovereignty of the people, it develops democratic policy and lawful rule. Based on protection of private property, it develops a market economy. In an atmosphere of freedom, equality and universal fraternity, it creates a multi-faceted humanistic culture, and strives toward the realization of a prosperous, harmonious socialist society with a continually expanding citizens' self-government."
- Second, I recommend changing the name of the Chinese Communist Party to the Chinese Social Party.

- Third, I call for allowing competition within the Party.
- Fourth is the separation of four powers within the Party. The Party Congress and the resulting Party Congress Standing Committee should hold the decision-making power in the Party. The Party's Executive Committee chosen by the Party Congress should hold the executive power in the Party, and the Party's Commission for Inspecting Discipline should hold the oversight power in the Party. The members of the three bodies should not hold concurrent positions. Party papers and magazines should be operated by party members on their own.
- Fifth is establishing a system for generating Party revenues from privately collected voluntary

contributions and not government funds.

Civilized political views and the civilized political system must find their implementation in the civilized political conduct of individual citizens and legal entities. This includes renouncing violence as a principle, gaining an attitude of tolerance, dialogue and negotiation, doing things in a lawful manner, and promoting the social climate of active citizen participation in the administration and discussion of state affairs. The ability of citizens, under the protection of a legal system, to actively participate in the administration and discussion of state affairs is the best general indicator of the degree to which the political conduct in a given society is civilized.

Currently, China has a Constitution but no Constitutional rule, a widespread belief that China cannot blindly copy foreign experience, a system in which the Commission on Politics and Law of the Chinese Communist Party undermines the independence of the judiciary, a system of "labor education," and a double standard that violates civil rights. I hope that the ideas I have put forward will offer the 1.3 billion Chinese a clear overall picture of political reform that can serve as fodder for debate.

(Footnotes)

¹ The despotic ruler who united China, the first emperor of Qin (259 - 210 B.C.)

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The Center for International Private Enterprise
1155 15th Street, NW, Suite 700, Washington DC 20005
Phone (202) 721 - 9200 Fax: (202) 721 - 9250
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The Other Path: --- The Economic Answer to Terrorism ---

Interview with Hernando de Soto

Hernando de Soto is the President of the Institute for Liberty and Democracy in Lima, Peru and author of "The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else," and "The Other Path: The Economic Answer to Terrorism." The new edition of the Other Path contains a preface that outlines the successful strategy that the ILD used to discredit the Shining Path's appeal. The Center for International Private Enterprise has worked with and supported the work of ILD since 1984.

CIPE: In the preface to "The Other Path," you quote Abimael Guzman, the founder of the Shining Path terrorist group in Peru, in which he basically blames the work of ILD for the defeat of his movement. I was wondering how the terrorist organizations, and also the communist/Marxists organizations, reacted to ILD's challenge and why you think that your message posed such a significant threat to these groups?

Hernando de Soto: Abimael Guzman, who headed the Shining Path terrorist movement, labeled us as their principal enemy. He bombed our offices with over 500 kilos of dynamite and our vehicles and offices were machine-gunned continually. The reason is that we were considered reformists, and reformists are the worst enemies of the Maoist or a Marxist-Leninist because they reduce the contradictions in the society.

We knew that what gives terrorists power is the hope that the majority of people are sufficiently alienated from the existing political system that they can be recruited and become a base of support. Therefore, the crucial

anti-terrorist mechanism is one that involved the excluded in political reforms so that they have a voice, and in property reforms so that they can work and prosper within the market.

We made it much less possible for the terrorists to recruit unhappy people for their ranks. We were a threat to them on the ideological front to the point that Guzman said in his official newspaper that he could not recruit due to the book "The Other Path" and how it was circulating in universities. In practical terms, the traditional communist organizations, like the Transport Trade Union, all abandoned communism in a very public way by publishing large advertisements in newspapers. This was their way of going on the record and saying that they were dropping the "Shining Path" and now we are heading towards the "Other Path."

CIPE: Vin Weber, Chairman of the National Endowment for Democracy and a former Congressman, said in a speech at CIPE recently that, in his view, terrorism isn't really caused by poverty but by the absence of hope - specifically when a people felt

they had no hope of changing their political or economic institutions. Does this explain why we see people like Mohamed Atta, a man from Saudi Arabia with a university degree, taking up terrorism? Is the message of the ILD the antidote to terrorism because it offers that hope of change and reform?

Hernando de Soto: I completely agree with Mr. Weber. Poor people are generally very peaceable. The people that get angry are those who are excluded, and because they're excluded they have no hope and become capable of extreme violence. The solution is to give them hope, and to do that you've got to interact with them. At an institutional level this means promoting the establishment of democracy and opening up opportunities that the expanded marketplace can provide. I think that ILD's proposal is one entry point to this solution. At one time, the Shining Path in Peru comprised over 80,000 armed insurgents and it was defeated ideologically, not on the battlefield but simply by giving people hope. We started opening up the legal system to the people's participation and to their entrepreneurship.

CIPE: You founded the Institute for Liberty and Democracy in 1984 to begin defining and seeking solutions to the problem of why capitalism didn't work in Peru and other developing countries. Do you think you've found the answer as to what needs to be done?

Hernando de Soto: I think we have found some answers, and they revolve very much around a set of rules or laws that compromise the basic elements of a capitalist or market economy system. It is these rules that allow people to take advantage of their natural entrepreneurship. We have found that the economic entry point relates very much to property law because those that are excluded, mainly the poor, will understand the rule of law and the rules of the game much better if it affects the things that concern them the most, which happen to be the land they own, the homes they own, and the businesses that they operate.

On the political side participation is crucial and capitalism doesn't work unless it continually gets feedback from the market as to how to make those rules function. Partial democracies like the one we have in Peru, which are limited to elections and don't have participation in the acts of government, deprive the government of both the information it needs to make the rules work and of the accountability which is necessary to enforce the reforms that are required.

CIPE: Since your work places such an emphasis on institutions, can you tell us what are the key institutions and why don't they exist in developing countries?

Hernando de Soto: I think the key institution is property law. The reason it doesn't exist today in developing countries is that many of these countries use statutory law or civil law. Countries with civil codes in the West did not spontaneously evolve their legal systems and it is unlikely that the developing world will either. Western European countries that have Roman law, like France and Germany, had to make a deliberate reform from old patrimonial and mercantilist legal orderings to one which provided space for both property and democracy. Those enormous social and legal re-

Democratizing Government Decision-Making

Major Legal Reforms Designed by the ILD

Reforming decision making procedures

Bringing the people's voice into the law-making process has become an established political ideal in Peru after the ILD completed its first project, handing President Belande a draft for legislation, the goal of which was to keep lawmakers informed about the public's concerns and make them accountable by giving the people an opportunity to comment on the drafts of the laws as well as their effects.

Activating Peru's First Ombudsman

In 1984 the ILD mounted a campaign for an independent national "ombudsman" to represent the interests of citizens, no matter how poor they might be. The ILD's hard work of setting the ombudsman concept into motion turned out not to be in vain: Peru's New Constitution of 1993 incorporated the Office of the Ombudsman as an autonomous entity.

Access to Public Information

Throughout the 1980s, the ILD continued to work toward making the Peruvian government more accountable to the people. Seven years later the proposed law was incorporated into the 1993 Constitution.

Bringing Extralegal Property into the Legal System

The ILD launched a campaign to probe public opinion about what informal legal arrangements people actually had to secure and transfer their assets in the extralegal sector. The information gathered from these meetings allowed the ILD drafted the "Property Registry Law," which was unanimously enacted into law by Peruvian Parliament.

Administrative Simplification

To deal with the queues, paperwork and excessive bureaucratic procedures that caused most Peruvians so much lost time, unnecessary expense, not to mention the general constraints on economic activity, the ILD created a draft of the law and an administrative strategy to streamline bureaucratic procedures and facilitate institutional reform. As a result the ILD's draft was unanimously approved in Congress by all political parties and became a law.

The Unified Business Registry

In September 1990, the ILD presented the president with a draft law aimed at reducing the time required to obtain a license to operate a business legally. The existence of the new government agency, established by the government, reduced red tape and costs dramatically: the nearly 300 days it took to obtain a business license were cut to one day, and the cost was slashed by seven times.

The Municipal Operating License

The ILD proposed in May 1990 to all of Peru's municipalities a public ordinance for simplifying the granting of municipal operating licenses. Some ten municipalities adopted the ILD's model ordinance and thereby cut the costs for obtaining municipal licenses for a business from \$690 to \$70 and reduced the bureaucratic gauntlet from two months to one day.

The System of Arbitration

To create a conflict resolution system that would be accessible to the poor, the ILD studied the limitations of the official legal system along with the extralegal mechanisms that the poor themselves used to resolve their disputes that were relatively efficient. ILD's draft of the law which addressed the problem was included in General Arbitration Law No. 25935.

engineering jobs of Germany in the 19th century, or what the French did with their civil codes, are simply revolutions that have not yet taken place in developing countries.

I think there are other reasons as well. One is that the European reforms came as a result of large migrations, which created the pressure for the feudal and patrimonial systems to collapse and obliged the Europeans to reconsider social organization as their cities or towns grew. That migratory phenomenon and that pressure has only come to most of the developing world in the course of the last 50 years, and that's why I think that we are now ripe for that reform.

The reason that developed countries have had difficulty in helping us carry out these reforms is because the Europeans and North Americans that knew something about these reforms lived in the 18th, 19th, and early 20th century, and those that live in the 21st century have forgotten all about it.

CIPE: You have made some very concrete recommendations about helping the poor to register their businesses so that they can join the legal economy. Have most of your recommendations been implemented?

Hernando de Soto: Most of our recommendations have been implemented, but the problem is not fully. Property legislation and the recording systems that now exist in Peru were originally designed and run by ILD and they have worked. Most of the reforms we proposed at the political level, including comment and notice periods, the ombudsman system, the accountability systems, the procedures for cost and benefit analysis of legislation before it's carried out, *et cetera*, are all now in the constitution. The problem is that in many cases the constitution has not been enforced, and in other cases it's only been enforced half-heartedly.

This, of course, is disappointing, but what's interesting is that our reforms continue to be part of the national agenda. For example, one reform that we thought was indispensable had to do with access to public information. And it's only now, years later, that the Congress is starting to implement it.

It will take probably a decade or two before the system fully adopts what we began.

CIPE: You also make a very strong case about why poor people don't have property rights and why and redistribution systems have always failed. What is your recommendation and have your ideas been put into place in Peru?

Hernando de Soto: We have been successful in the sense that those areas where our system has been allowed to function, specifically the urban sectors of Peru, over 75 percent of all the real estate and other business assets are now legal. What is missing are the legislation and rules that connect property rights to capital formation, such as the securitization of credits, the enforcement of mortgages, and other financial and investment devices.

We've got most of the people into the formal economy, but what's still missing is giving them the tools with which these property rights allow them to leverage their assets appropriately. Most of the reforms are actually already designed, and we're getting there but, unfortunately, very slowly.

CIPE: Since working in Peru, ILD has developed initiatives in El Salvador, Haiti, Egypt, the Philippines and other countries. How have those efforts fared to date?

Hernando de Soto: These are all projects at different stages. For example, in the case of El Salvador, the system we initiated there ten years ago has already legalized over a quarter of a million previously illegally-settled plots of land. This process is accelerating and nearly one million farmers and other individuals are expected to have gained legal titles to their land by next year. The registry system now records approximately \$800 million in mortgages per year.

In Haiti, we have worked with the government to finalize proposed legislation that will change the legal system so as to include the poor. We hope that the Haitian parliament will pass the law, allowing us to begin implementing the reforms before the beginning of next year. The reform process is in a less developed stage in

the Philippines but in Egypt it should be ready for implementation by early 2003.

It is important to understand that the whole reform process, including the inventories that have to be made of existing extralegal assets in the country and the informal organizations that must be asked to participate, never takes less than five years.

CIPE: What do you think it's going to take to accomplish the last phase of reform in Peru, specifically improving the access to capital?

Hernando de Soto: I think that leadership is crucial to any reform program. If the head of state does not understand the reforms and doesn't take an active role in promoting them, they won't happen. You can have the best plans in the world, but if the political leadership doesn't understand and isn't behind them, they won't happen, or they'll happen very slowly. In Peru, the problem we have is that the current President has lost his leadership: he is now disapproved of by more than 80 percent of the populations and, I suspect, has always had personal difficulties in grasping the meaning of the impact of institutions. I think that he is a good man but lacks the cognitive abilities to comprehend abstractions.

CIPE: Since your two books came out, a series of economic and political crises have hit Latin America with the most recent example being Argentina, long held up as a model of reform. What do these crises say about both the commitment of the region to democratic ideals as well as the capacity of Latin American institutions to foster competitive market economies?

Hernando de Soto: The commitment in the region to democratic ideals as well as to competitive market economies is still there. In Colombia, Alvaro Uribe was recently elected President, and he is very committed to both democracy and a market economy.

The election in Bolivia of Gonzalo Sanchez de Lozada, a committed free-marketer and a democrat, and the likely victory in Brazil of Luiz Inacio Lula da Silva, who has expressed his commitment to democracy and a

competitive market economy, is further evidence of the strength of democracy in Latin America.

What the crises tell us is that macroeconomic reforms have not gone far enough. It's not sufficient to have a policy goal for a stable currency if you do not have the democratic instruments with which you can control the expenditures of politicians. In the case of Argentina it is quite clear that many of the politicians, especially those who ran the provinces, spent themselves into a fiscal deficit that eventually sent the stability of the local currency tumbling down. If politicians are not accountable, if figures are not transparent, if people do not have sufficient property rights to leverage their assets then no amount of good macroeconomics is going to help because you simply can't control spending, and you are not able to unleash all of the forces that make a market economy successful. According to a comment made to me by Domingo Cavallo, the previous Minister of Finance of Argentina, 50 percent of Argentines do not have clear and transferable property rights.

CIPE: You describe the importance of stronger protection of property rights in Western countries in your book, *The Mystery of Capital*, and how that process has evolved over hundreds of years. How can developing countries leapfrog their way to stronger property rights protection so that it does not take them the same amount of time to develop?

Hernando de Soto: We've got plenty of good examples of countries that made this developmental leap. From the late 1930s to the end of World War Two, Japan's GNP per capita was 20 percent below Peru's. Millions of Japanese, including the family of President Fujimori, migrated to Peru and Brazil, which also had a GNP per capita higher than Japan.

Today Japan has a GNP per capita that is at least five to six times higher than ours because they leapfrogged to a property system that was basically set up at the urging of U.S. occupying forces. A similar process took place in Taiwan and South Korea. At the beginning of the 20th century, Switzerland was the poorest country in

On February 13 2003, the Center for International Private Enterprise (CIPE) and the National Democratic Institute (NDI) hosted a conference at the Hall of Flags at the US Chamber of Commerce to hear different independent accounts of the Institute for Liberty and Democracy's (ILD) experience in peacefully fighting for development and against terrorism.

The ILD was created in Peru in 1982 in the midst of deadly attacks by a home-grown terrorist group known as the "Shining Path." To achieve development and counter the terrorist extensive efforts to recruit among Peru's poor, the ILD designed and implemented various institutional reform programs to integrate the poor into the market economy and make the rule of law accessible to all.

Most of these programs were successful. According to the Shining Path's official newspaper, the ILD's measures crippled their recruitment efforts. The terrorists were dealt other damaging blows when grassroots associations, coca growers, farmer militias and unions adopted the ILD's programs and ideas. These Peruvians as well as representatives of international financial institutions, foreign correspondents, foreign affairs officers and distinguished military who supported or observed the ILD's efforts explained how ILD's non-violent institutional and economic reforms can effectively help to defeat terrorism.

Over the past two decades, the ILD has been successful both as an intellectual force for change and on the ground, moving millions of businesses and homes from the underground economy into the economic mainstream. More than 20 heads of state in developing and former Soviet nations have called on the ILD to help them implement the model of reform that they have created.

Full conference report and recorded proceedings of the conference are available on CIPE's website at www.cipe.org



Western Europe until it re-engineered the property system through the creation of the civil code of 1908, launching it into prosperity.

We studied all of these transformations quite closely, and it is on the basis of these experiences and our own projects that we are working all over the world. In other words, there is a blueprint and we have it.

CIPE: In the preface to the new edition of *The Other Path*, you state that there is class warfare in Peru but that it is characterized by a vertical line rather than a horizontal one. Can you describe what you mean? How does this class warfare account for current populist trends visible throughout Latin America?

Hernando de Soto: The Shining Path believed in the Marxist tenet that Peru had a horizontal line that separated entrepreneurs, who owned the means of production, from a huge proletariat that only had their labor to offer. Our research showed that the formal proletariat of Peru was no more than 5 percent of the population, and that actually 70 percent of Peruvians were entrepreneurs. The division line was not between a proletariat and those who had the means of production but, rather, a vertical line between those who had the means of production and competed in an open market outside the legal system and those who had means of production with special access to government and were supported by official law. Therefore, the challenge was to destroy that vertical line so that everybody could compete and have a chance to produce wealth and accumulate it under the same rules of the game. This reality completely undercut the Shining Path's message of class struggle and eventually led to their defeat.

CIPE: How does this new vertical class warfare relate to the current populist trends we see in Latin America these days?

Hernando de Soto: I think that in the case of Peru those who implemented macroeconomic reforms have been unable or unwilling to address the need for legal reforms and that slack has been taken up by the old left. While in some countries the old left is actually democratizing the notion of capitalism,

as is the case in Chile, in countries like mine, unfortunately, the left insists on a return to the old, failed, populist policies of the '80s, which is why their predominance will not last. I think Chile's experience indicates, like that of New Labor in the U.K., that it is not necessarily the right that is going to implement the fundamental market reforms that reach the people. These reforms can also come from converted leftists. The populism that you're seeing today in Latin America is simply an attempt by former leftist to find a way to spread the benefits of capitalism to accommodate their social goals to the capitalist model.

CIPE: Many voices in the news today are proclaiming the failure of market reforms in Latin America. However, you describe Peru, for example, as having never progressed past a mercantilist economy. Can you elaborate on your point of view and explain what this means for international donors who are looking to foster democratic institutions and market economies?

Hernando de Soto: Market reforms have not failed in Latin America, they have not been tried out. What has been tried out in Latin America is macroeconomic reform. The reforms that are required to create a legal framework within which everybody can compete in a capitalist economy must begin through the reform of property law.

In the West, property is generally taken for granted and is perceived as an ownership issue, which is why so much foreign aid is focused on simple land titling efforts. However, for us at the ILD, we have learned that a good property system goes far beyond the protection of ownership. It is the hidden architecture that actually organizes a peaceful capitalist market economy. It is property law that provides the framework of rules that organize the market, the titles and records that identify and locate people, business, and organizations that underlie all the contractual mechanisms that allow economic agents to exchange goods and services in the expanded market. In other words, it's property law that provides the means to enforce rules and contracts and facilitates the procedures that permit citizens to transform their assets into capital

they can leverage through credit and investment.

The problem is that not only have these reforms not begun, but if you look at the budget items of all bilateral foreign aid assistance programs, from whatever developed country, and even those of international financial institutions, you will not even see a line item for them. The real basic revolution of a market is essentially a property revolution. It involves everybody having access to assets and to have them represented in such a form that they can enter the market.

Nobody in the United States drives 10,000 head of cattle into the Chicago Mercantile Exchange. I don't see people in Wall Street buying and selling hardware or computer disks in the market. All they basically exchange is property paper that represents assets. Without a property system that represents assets, the market cannot function, and that revolution has not yet begun in most of the developing world.

In Pursuit of the First Freedom:

Exploring the Links Between Democratic Local Governance and HIV/AIDS

*by Mathias Zana Naab and Colette L. Bottini
International Republican Institute*

The AIDS pandemic is emerging as one of the most prominent challenges to government in poor countries, especially in Africa where 70 percent of the world's infected population lives. This challenge is on all levels, from national government which is looked to for leadership in policy response down to the grassroots level where local leaders deal with the day-to-day issues of sickness and orphans.

The objective of this article is to document reflections on the link between democratic governance and the AIDS pandemic in Africa. It is our belief that the HIV/AIDS pandemic poses a serious threat to democratic governance. We also believe the stability of and continued strengthening of democracy and governance infrastructure plays a crucial role in combating AIDS and its devastating effect on African development.

The Problem

AIDS is not just a public health problem. It is universally acknowledged that there is a strong, positive correlation between the pandemic of HIV/AIDS and general development progress. Since the pandemic began, it has killed millions of adults in the prime of their working and parenting lives, has decimated the workforce, has fractured and impoverished

families, has orphaned millions, and has shredded the fabric of communities. Nearly 70 percent of the world's HIV/AIDS infected people and 90 percent of AIDS deaths are found in a region that is home to just 10 percent of the world's population. Infection levels are highest in the sub-Saharan region where access to care is lowest, and social and economic safety nets that might help families cope with the impact of the epidemic are grossly inadequate.

It is imperative to note that national AIDS programs in a number of countries have suffered from the problems of a weak enabling environment characterized by low political legitimacy of government, reluctant leadership on the issue, lack of transparency and accountability, absence of respect for human rights, and uncoordinated external assistance. While a good enabling environment alone will not bring about a successful fight against HIV/AIDS, it is our conviction that such an environment is a necessary precondition for success.

Paradox of the Failed State

During the 1980s and 1990s, Africa entered a far-reaching process of political and institutional reform, which has transformed the institutional and policy environment within which development takes place. External pressures coincided internally with

growing public frustration with post-independent governments' failure to respond to popular demands, to stimulate economic growth, to provide a basic level of development, and to embrace basic democratic rights. These concerns reflected a deeper crisis in governance and prompted calls by civil society and the private sector for more open, accountable, and effective government and for the creation of opportunities for more active participation in the development process.

Political reform embraced a renewed interest in political and administrative decentralization with several countries moving to devolve powers to locally elected and accountable administrations. These processes have included the shedding of functions to non-governmental actors and have given rise to a wider recognition of the potential benefits of a more participatory approach to development management. The legitimate role of civil society and of the private sector in participating in the formulation and the execution of policy has been increasingly accepted.

The institutional context of development has changed dramatically over the past decade. New and more participatory forms of governance are beginning to emerge. The role of the state in development has changed from

less doing to more facilitating. Greater onus is placed on an approach that values the participation of different actors towards achieving common development goals. It is within this perspective that the discussion on the link between democratic governance and HIV/AIDS can be examined.

Democratic Local Governance

Manuel Castells, in his writings on global social dynamics, said "the most powerful trends legitimizing democracy...are taking place, worldwide, at the local level". Decentralization and the development of democratic local governance are taking center-stage in the current development discourse; an increasing number of countries are decentralizing central government's administrative, fiscal, and political functions to lower-level governments in the hopes of improving governance and public service delivery. Democratic local governance is expected to result in more efficient, effective, sustainable, and equitable outcomes.

It is clear that central government will need to play an ongoing role, albeit a different, more supportive, and less directive role. Top-down support is required for bottom-up initiatives to succeed, but top-down designs can stifle local initiative, particularly if they are imposed in standardized ways, insensitive to regional and local differences. Inter-organizational partnerships between local governments and community organizations are necessary and useful in many circumstances--especially in the fight against HIV/AIDS.

Information, Access and Collective Action

Three key factors are involved at the local level in achieving the objectives of democratic local governance: information, access, and collective action. These key elements are critically implicated in local governments' interactions with their constituents. Attending to these elements helps achieve the objectives held by democratic local governance. Accountability improves when citizens empowered with adequate information can collectively mount pressure on local officials. Democracy and equity are better served when large numbers of

citizens can relatively easily gain access to public decision-making forums.

Collective action is critical for achieving the ends expected of democratic local governance. By disseminating information, providing access, and organizing collective action, community organizations (civil society) can help enrich governance at the local level. Local governments' performance is improved when civil society provides access and information to citizens and when they help bring communities' social capital to bear upon local projects.

Conversely, the utility and effectiveness of community organizations can be enhanced considerably when appropriate incentives are provided through government action. The analog at the local level consists of organizing appropriately structured partnerships between local government and community-based organizations.

The Impact of HIV/AIDS: Eroding the Capacity to Govern

It is imperative to consider the effects of the AIDS pandemic on democratic governance; not nearly enough research has been conducted on measuring the impact that could mean, at its most extreme, political collapse for countries and regions.

The pioneering work of the Health Economics and HIV/AIDS Research Division of the University of Natal in South Africa has noted some of the following effects on governance, including: the significant number of government workers who are or will be infected or affected by the virus; the increasing demands that will be placed on government and public resources across all sectors, while at the same time that revenue is decreasing due to mortality rate; the compromised efficiency and legitimacy of government administration and services if steps are not taken to manage the organizational impacts; and decreased citizen support and involvement in civil society and government.

Government can respond to these issues and play a crucial role in alleviating the effects of AIDS through legislation and other policy and legal responses, strong leadership on the issues, and

creating effective partnerships between government and civil society.

Local Governance in Action against the AIDS Epidemic

The International Republican Institute has been conducting a local government training program in South Africa for the past several years. The program is run by a South African staff and centered in Kwa-Zulu Natal, which is not only the most populous province but also one of the most highly infected with HIV/AIDS. For local councilors--many of whom were newly elected and newly empowered--trainings have focused on strengthening accountability and improving administrative functioning in areas such as financial management, service delivery, and strategic planning. Such close and sustained work with local government officials has yielded some powerful observations about the situation of the AIDS pandemic at the local level.

One such observation is the local government's unique position to mount a front-line response to the HIV/AIDS pandemic. While the national government has in many ways taken its time in responding to the pandemic, AIDS continues its march through communities, and the resulting needs inevitably confront local officials who do not have the leisure to deliberate over technicalities. As the level of government closest to the people, these are representatives to whom community members come with real and immediate needs such as orphan care, funeral costs, and health services. The AIDS pandemic and its related effects have severely increased demands on local budgets and services.

While local government itself certainly does not possess limitless resources to devote to these needs, it can, as has been discussed here, play a crucial role in linking community members to organizations active in these issues. However, conversations with both elected officials and municipal staff have revealed a distinct lack of information-sharing. Despite the sometimes staggering number of NGOs and CBOs working throughout the country, local government often seems to have scant knowledge about the

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Governance in the Transition Economies:

Current Issues in Bulgaria

Prof. Bistra Boeva
University for National and World Economic Studies
Sofia, Bulgaria

Introduction

Developing sound principles of governance in emerging markets has been one of the top issues for local reformers and international organizations in the last decade. Various questions concerning the role of governance and its contribution to the reforms in the developing countries have been raised by policy makers, scholars, business leaders and stakeholders on both national and international levels. However, transition economies continue to face problems in establishing good governance mechanisms.

Problems persist in the transition of ownership and the changing role of the State in creating a new type of relationship between the state, society and business. The ongoing reforms in these economies have created a new framework for business activities, one in which respective economic, administrative, information and legal instruments have not automatically lead to a market democracy, or to the establishment of governance institutions. In reality, governance issues have to be addressed independently - as an important and a separate part of the transition process. The State and society should both be actively involved in the process of building new institutions and the mechanisms of governance.

Governance deals with the relationship between the State, society, business and other stakeholders. This relationship did not exist in a planned economy and must now survive the challenge of corruption, bureaucracy, over regulation, drawbacks in exercising legal, executive and judiciary powers and the lack of democratic values. Given different economic, social and political environments, transition economies follow different paths towards governance reform.

In Bulgaria, politicians and government officials initiated anticorruption measures and started dismantling administrative barriers while some NGOs tried to affect the relationship between citizens, the business associations and the government. However, these initiatives do not address the fundamental issue of establishing an adequate system of checks and balances for the market democracy. The effectiveness of these initiatives in building governance systems has been unfortunately low. The success of a good governance practice is determined by the implementation of a broad range of rules and norms, with which the State and society comply in the developed market economies.

Good Governance in Market Democracies

The system approach towards the establishment of governance requires both policy-makers and stakeholders to have a coherent vision about the essence of governance and the mechanism of checks and balances. The current practices in democratic societies suggest a variety of views and definitions about what governance is and what are its basic norms.

According the Commission on Global Governance, governance is the sum of the many ways individuals and institutions manage their common affairs. It is a continuing process through which conflicting or diverse interests may be accommodated, and co-operative action may be taken. It includes formal institutions and regimes empowered to enforce compliance as well as informal arrangements, that people and institutions either have agreed to or perceive to be in their interests.¹ "Governance comprises the traditions, institutions and processes that determine how power is exercised, how the citizens are given a voice and how decisions are made on issues of a public concern," states the Canadian Institute on Governance.² And according to the white paper of the European Union, governance means "rules, processes and behavior that affect the way in which powers are exercised at the European

Union level, particularly as regards openness, participation, accountability, effectiveness and coherence.”³

These definitions reveal the broad range of views on the nature of governance. From the perspective of the governance agenda in transition economies, these definitions could be considered not only a theoretical, but also a practical milestone, indicating the main components and objective of governance. It is important for the policymakers, businesses and stakeholders in the transition economies to be familiar with the basic principles of governance. While the definitions vary, the core of governance evolves around the ideas of openness, accountability, partnership

and coherence. For example, the Asian Development Bank focuses on: transparency, predictability, accountability, strategic focus, efficiency and effectiveness, and participation.⁴ Every single principle sets out norms and standards for behavior of the respective governments and the society as a whole.

Government compliance with the principles of openness and transparency and free flow of information to the business and community in a simple and easily understandable way is vitally important to the practice of good governance. Openness requires the participation of society at large in the political and policy-making process from conception to implementation.

In countries with well functioning governance mechanisms, it means obligatory consultation of the executive and legislature with businesses and society in the course of any important legislative and political decisions. This openness has been a key element in public administration reforms in many OECD countries as well. Openness and transparency also require accountability to be truly effective.

Accountability sets out well defined and balanced duties and responsibilities of the three branches of power: executive, legislative and judiciary. Openness and transparency require governments to inform society about their activities, achievements, and problems, generating a public demand

Table 1. Issues in State Governance⁵

Basic Characteristics	Features	Measurement
<ul style="list-style-type: none"> Process by which governments are selected, monitored and replaced. 	<ul style="list-style-type: none"> A. voice and accountability B. Political instability and violence 	
<ul style="list-style-type: none"> Capacity of Government to formulate and effectively implement sound policies 	<ul style="list-style-type: none"> A. Government effectiveness B. Regulatory burden 	<ul style="list-style-type: none"> A. <ol style="list-style-type: none"> Quality of public service Quality of bureaucracy Competence of civil servants Independence of civil servants from political pressure Credibility of government commitments B. <ol style="list-style-type: none"> Price controls Inadequate bank supervision Perception of burdens imposed by excessive regulation in areas such as foreign trade and business development
<ul style="list-style-type: none"> Respect of citizens and state for institutions that govern economic and social interactions. 	<ul style="list-style-type: none"> A. Rule of Law B. Fraud and Corruption 	<ul style="list-style-type: none"> A. <ol style="list-style-type: none"> Effectiveness and predictability of the judiciary Enforceability of contracts Fair and predictable rules form the basis for economic and social indicators B. <ol style="list-style-type: none"> Measures of perception of corruption Measures of the use of public power for private gain

for efficiency and effectiveness. This demand, in turn, promotes the supply of public goods according to clear cut objectives, based on analyzed past experience and the assessment of future impact. In many developed market economies, compliance with the principles of effectiveness and efficiency drive the establishment of the cost benefit analysis as a part of the elaboration of legislative and executive initiatives.

Good governance in practice is more than just a set of definitions. It is about institutions that are embedded in the political, social and administrative infrastructure of a country. Governance is a system of norms, of checks and balances for a partnership between the State and society within the framework of a market democracy.

A practical model provides a more concrete approach towards governance than the theoretical assumptions. It helps guide policy makers, businesses and stakeholders through the process of establishing governance institutions in transition economies. For instance, the right to vote takes various forms and shapes. The basic right to vote is combined with the right of business and society to participate in important economic and political decision-making. In turn, the State creates effective structures for these discussions and minimizes transaction costs and barriers to entry. The establishment of effective institutions contributes to the success of economic and social developments. The importance of a formalized system of transparency and accountability is evidenced by the improvement of the quality of services provided by the State, and by the increase of access of society and business to public information provided by the State.

A practical model also helps to identify needed measures to counter the undermining effect corruption. Business regards corruption as a tax or barrier to entry into the market, while to society, corruption is associated with limited public expenditures for education and health. Corruption limits participation of the poor in the decision-making processes and it limits the development of good governance practices.

Finally, it is important to point out that the approach towards governance, that the model promotes, is important from both theoretical and practical aspects. For policy makers, it means a broader framework for establishing the institutions and norms of democracy. For businesses and society it means a better mechanism of checks and balances that positively affects relations with the State, and also protects their rights and interests. The holistic approach reveals that effective governance also contributes to sustainable economic development. Governance is seen as the ability to keep social peace, to guarantee law and order and to promote economic growth. This makes the establishment of good governance in transition economies a priority for still ongoing reforms.

Transition from a Planned to a Market Economy

Bulgaria has been moving from a planned to a market economy for the past decade, making tremendous changes in terms of privatization, reducing state intervention in economic and social life and in building the institutions of a democratic market economy. These reforms are allowing Bulgaria to start to integrate into the European Union and into the global economic infrastructure. The fundamental changes in economic, social and political life have led to the establishment of the basic principles of governance, but it is important to point out that the building of governance institutions was not a priority for policy-makers at the beginning of the transformation process.

The need for reforms and the lack of adequate rules for the market democracy drove the activities of policy-makers, NGOs and other stakeholders towards the establishment of governance institutions. The theoretical model of governance and the achievements of good governance practices in democratic societies turned out to be a useful benchmark in order to address the question of the status quo of governance in Bulgaria. Various NGO's and think tanks that support institution-building, are analyzing Bulgaria's progress in this regard to answer the questions: What is the

status of governance in Bulgaria in the second decade of reforms? And what issues still need to be addressed?⁶

One issue identified by the Bulgarian business community are bureaucratic barriers in working with government agencies. New businesses face a huge number of administrative obstacles in licensing. The government has responded to this problem by abolishing 74 licensing regimes and simplifying 120 others. While Bulgaria seeks to further harmonize its legislation with EU standards, the business community expects new difficulties with the licensing regimes due to the lack of adequate legal measures and weak cooperative dialogue between business and policymakers. Both local and foreign business groups support abandoning the burdensome system of licensing.

The other issue is the lack of a formal system of consultation between government and business. Frequent changes in the legal framework are also a problem that creates a barrier for economic activity because of difficulties in complying with the law. The Bulgarian business community believes that the lack of a standard system for consultation between stakeholders and respective executive and legislative powers causes a lot of these difficulties. Corruption also continues to be a problem despite many anti-corruption measures approved by policy makers and the business community. Again, the cause is an inefficient administrative systems and drawbacks in the judiciary system.

These conclusions are supported by my own analysis of the basic principles of governance: transparency, accountability and efficiency. This survey analyzed how governance principles are viewed by the government and the business community and found that some of these basic principles were violated. A serious criticism of the government by the business community was due to a lack of transparency and limited access to information produced in the various government agencies. A new social code created in 2002 was also seriously criticized by the biggest employer associations in the country, who accused the government of a lack of respect for their rights and interests.

While the analysis suggested the continuing need to develop governance institutions in the country, positive trends have been reported as well. Current government initiatives to establish a market democracy in Bulgaria include:

- A national anticorruption strategy
- A modern administrative system
- Internet based government, or E-Government
- The establishment of a national council for economic growth, which would include government officials and the representatives of the biggest employers associations in the country.

From the perspective of governance, a national council for economic growth represents an example of a formal system of consultation between government and the business community. The council for economic growth would address crucial issues for the business community, as well for society.

It is expected that these and other similar activities will contribute to the establishment of institutions of governance in the country. The process of building governance mechanisms is a long and a continuing one, requiring commitment from both the State and society. It requires that certain issues be addressed including the lack of consultation between the executive and the legislature and inefficient and burdensome legal norms.

The lack of legislative norms also hinders the implementation of good governance principles. Despite legislative reform introduced in the mid 90s, the legislative system is still accommodates some laws written during socialism. A law providing norms and requirements for the law-making process that does not establish a formal system for vertical consultations with stakeholders and only requires horizontal consultation with the respective ministries and state agencies leaves almost no opportunity for the public to be heard by the authorities, resulting in negative impact on the quality of laws and the stability of the national legal framework. However, while reform is needed, frequent changes of laws can also cause unstable legal environment and risks.

In many instances policy-makers ignore the interests of the parties that are directly affected by the laws and regulations they draft. One example is the adoption of the tax laws at the end of 2001 in which the state agency ignored the business community's opinion on amendments to the tax legislation. This lack of consultation between the State and business caused social tension and required changes in the freshly adopted laws.

The solution lies in accelerating the process of embedding the norms of good governance in Bulgaria's economic, political and social environment. This could follow different scenarios, but which scenario is the adequate one in terms of the long term orientation of the country?

A more realistic scenario

Good governance in market democracies has to be a priority for policy-makers in transition economies. Opinions differ on the practical and reasonable measures, which have to be initiated for this practice to become a part of the economic, political and social life in the counties moving from a socialist system towards a market economy. In Bulgaria a realistic scenario includes:

- A systematic effort by all powers toward the establishment of the institutions of modern governance.
- Continuing the reforms of the administration.
- A balance in policy-making priorities between economic, political and social initiatives.
- The introduction of efficient good governance practice such as cost benefit analysis and improved consultations.

It is important to combine both the long term objective, or systematic approach, to building governance institutions with the short term objective of introducing some governance efficiency methods. The adoption of the cost-benefit analysis (CBA) by the executive and legislative branches of the government is currently implemented by many governments. And while opinions differ on the advantages and disadvantages, CBA is a progressive technique that requires an analytical and prudent

approach in the various stages of the decision-making process, including:

- A detailed and concrete analysis of the problems, caused by the state regulation.
- A full assessment of the costs of implementation of proposed legislative or executive initiatives.
- A full assessment of the benefits of proposed legislative or executive measure for society, stakeholders and the business community.

In fact, CBA promotes the "economization" of the State's activities. It improves the quality of decisions and guarantees transparency and stability of the executive and legislative measures. For the transition economies, which are often short on qualified human resources in the State administration, CBA analysis mitigates subjectivism, corruption and supports the capacity-building process. While one cannot underestimate the drawbacks of this method, irrespective of the existing disadvantages, the implementation of CBA will support the functioning of basic governance principles such as accountability, transparency and efficiency. The people's confidence in governance institutions will be strengthened.

Another opportunity for the establishment of governance institutions is the building of a well structured system of consultation between the executive and legislative branches of government on one side, and the business community, stakeholders and society on the other. Good governance practices show that a well built system for consultation promotes the principles of transparency, accountability and coherence.

A system of consultation that provides for the involvement of society in the decision-making process is a better guarantor of market democracy, especially in comparison to old type cronyism. From the perspective of governance, these consultations are a more reliable institution that more accurately represents the opinions of society. New democracies in transition countries must develop their systems for consultation at the same time as they develop a legal framework for lobbyism. In transition economies

all players have to cooperate on the establishment of governance institutions.

In Bulgaria there are many business associations, but only some of them actively advocate for governance principles. Some associations only defend the interests of a few companies in specific sectors and not the interests of the total population, and in some sectors of the economy there are no business associations at all. This heterogeneous situation is not an exception and thus the future of governance has to be a product of both government and a wide cross-section of the business community and society. In some cases, the State may take a more proactive role in this process as determined by the nature of the transition.

Conclusion

Efficient governance requires resources, commitment and will that are carried out by the State, the business community and other stakeholders. Transition economies have to follow their own path in the establishment of governance institutions. While the good governance practices of developed economies suggest models and examples, the final decision about how to embed the principles and norms of governance is to the discretion of the State and the society in transition economies. The establishment of governance is a part of their hard work for sustainable development and growth of these economies.

(Endnotes)

¹ Commission on global governance www.cgg.ch

² The Institute on Governance, Ottawa, Canada

³ White Paper on Governance, EU, 2000

⁴ Asian Development Bank

⁵ The table is elaborated by the author of the paper, based on: Kaufman D.A., Kraal Pablo Aido-Lobaton, G Governance Matters, Policy Research, Working Paper 2196, Oct. 1999.

⁶ "Bulgarian economy in the First Quarter of 2002," Centre for economic development June 2002; and "Bulgarian Economy in the Second Quarter of 2002" Centre for Economic development, September 2002

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organizations working in its area, and communication between local government and such civil society groups can be very minimal. Access to such information and key linkages between government and civil society can play a decisive role in connecting the affected to services and resources.

Compounding the problem of resource allocation is a lack of administrative capacity. One municipal manager noted that 80 percent of the funds which were allocated to municipalities for HIV/AIDS mitigation was being held up at the provincial level because of an apparent administrative disconnection between the two governmental levels.

Such lack of information and administrative capacity can, more than many other factors, severely hinder the effect of the massive amounts of aid being leveled at the AIDS pandemic. No matter how much money is being channeled towards HIV/AIDS work, the bottom line is that without the capacity to disseminate these resources--whatever their source--at the local level and without communities and the affected having access to information, such aid will remain ineffectual and, at worst, untouched. Strengthening democratic governance at the local level is a crucial and necessary way of ensuring this does not happen. Local leadership and community coordination is key to both the treatment of and the prevention of AIDS' devastating consequences and must continue to be an important focus of AIDS interventions.

Building Partnerships in the Republic of Georgia: Tracking the Administrative Code

*Elena Suhir
Program Officer, Central Asia, CIPE*

On July 23, 1999 the Parliament of Georgia adopted the General Administrative Code, the aim of which is “to ensure respect by administrative bodies for human rights and freedoms, public interests, and rule of law.” This Code includes extensive provisions dealing with freedom of information and the transparency of public agency meetings.

The Code’s Freedom of Information provisions established a set process to seek information and appeal if requests are denied. Granting individual citizens the power to obtain information on the activities of local officials or agency spending dramatically changes the political culture. Each request for information may not be of monumental importance individually, but taken together and multiplied throughout the country it forces government institutions at all levels to become more accountable.

CIPE’s local partner, the Partnership for Social Initiative (PSI), has taken a leading role in monitoring the proper enforcement of the Code. According to Executive Director, Devi Khechinashvili, “PSI is engaging the business community and civil society in the policy-enforcing process to ensure the desired impact on government agencies.” PSI began by conducting a nationwide analysis of public perceptions and understanding of the provisions of the Code. PSI found that the government had done little to

make the public aware of the Code and its provisions and 24 percent of business owners had no knowledge of the Code at all.

PSI’s analysis also made clear that government agencies are not applying a number of the Code’s provisions in the way the law stipulates. This is partly due to lack of financing of administrative bodies, insufficient internal management, and the perception of public officials that under present conditions they will never be held responsible for ignoring the legislation. Also, while executive government agencies (Ministries) are more or less aware of their responsibilities under the Code, this is not the case with the regulatory agencies which are by law independent of the political process and thus are less inclined to abide by the rule of law.

Business Monitoring of the Georgian Administrative Code

PSI also surveyed businesses and civil society groups to identify concrete experiences and outline specific issues when attempting to use the Code. In addition to distributing their questionnaire within the business community, PSI advertised their survey in newspapers, association newsletters, and on state television, soliciting responses from civil society at large.

The most blatant and widespread violations of the Code were identified based on the number of organizations impacted and the importance to the country’s economy and development of a free market. The goal was to determine the extent to which government agencies comply with the Code and any follow-up court actions or actions by oversight agencies. In 20 percent of cases, government agencies failed to respond to information requests and only responded when PSI sent them and “administrative warning.” PSI was forced to file suit against one agency, the Ministry of Finance, for its refusal to respond, demonstrating that the Code is enforceable and requests for public information can be satisfied.

PSI has shown that appropriate implementation of the Administrative Code is possible through the efforts of interested citizens and informed courts. PSI built a coalition of 70 stakeholders and members of businesses and non-governmental organizations that expressed interest in the Administrative Code and were in a position to contribute their efforts to monitoring and advocacy activities.

Freedom of Information

According to the Freedom of Information provision within the Administrative Code, each government institution must designate an office or

officer to handle applications/requests/inquiries from the public. Any citizen has the right to obtain information from any government institution on a timely basis. However, financial and procedural impediments prevent the Code from functioning properly. Information offices at many agencies remain vacant due to a lack of funding for staff. In those cases where such an office exists, the employee delegated with this responsibility is part-time and primarily performs other duties, which often leaves information requests neglected.

PSI also found that the majority of requests that government institutions receive are from private individual citizens, NGOs and large and medium sized businesses. PSI held a series of roundtables in order to determine and address the specific reasons why small businesses are abstaining from requesting information from public institutions. The reasons cited by small businesses included a lack of resources to sort out complex administrative procedures or deal with unresponsive agencies. Their perception and experience was that the process to receive information was too time consuming and required insider connections and/or bribes.

To help educate businesses and the public about their rights to receive information from government agencies PSI published a booklet entitled the "Business Monitoring of Implementation of the General Administrative Code" in May 2002. The booklet provides a legal analysis of the various components of the Administrative Code as well as the results of its surveys. The booklet was distributed to individual businesses, business associations, governmental officials, academics, think-tanks, and the media.

Creating a public-private partnership

To achieve lasting market reform, the private sector must play an active role in the policy-making process. In Georgia, however, PSI's research found civil society groups and business associations are failing to take advantage of advocacy opportunities with policy makers. Public officials, on their part, do not feel a need to include the public in the decision-making and

legislative process, and argue that the Code does not provide for such an obligation. While some agencies believe that allowing civil society organizations to participate in decision-making will interfere with state interests, others simply lack awareness of the organizations that share their area interests.

To address this problem PSI developed a model for accrediting business associations. The goal of this activity was to provide a list of associations and other civil society organizations with specific issue interests or expertise that agencies can contact for input on proposed policy changes and reforms. PSI has established a pilot program with the Georgia National Center of Intellectual Property in which this agency has agreed to consult with the private organizations on its list. This pilot program serves as a model for developing similar accreditation processes at other government agencies. By matching business and professional associations and other stakeholders with government agencies, the extent of participation by civil society in the decision making process can be dramatically improved.

Case Studies

Association of Banks of Georgia and Pension Payment Tender

The issue of pensions is one of the most important political questions facing the country due to the level of dependency on this assistance and the government's difficult budget situation. Poor and corrupt management of funds by government administrators often causes delays in pension payments of up to three months. When the State United Social Fund of the Ministry of Health, Labor and Social Protection announced a tender to select a bank that would distribute pension to citizens across Georgia, the Association of Banks of Georgia (ABG) requested assistance enabling its representative to join the decision-making commission.

PSI and the Coalition launched an advocacy campaign targeting government officials and the public to ensure that ABG was included as a member of the tender commission. This helped determine the terms of the

tender and helped choose the winner during the competition. This was the first time that a business association was permitted to participate at such a high level of decision-making.

Poverty Reduction and Economic Growth Program (PREGP)

PSI's coalition members were determined to be included in developing Georgia's Poverty Reduction and Equitable Economic Growth Program. Using the rights provided by the Administrative Code, the Coalition gained access to the information on the structure of the draft document and program indicators that are being used to write the document. As a result of an active advocacy campaign, Dr. David Gzirishvili, PSI's Senior Fellow and Director of its Center of Social Welfare, was appointed by the government as an expert in the PREGP preparation process.

Conclusion

As a result of PSI and Coalition activities with the Poverty Reduction and Economic Growth Program and the State United Social Fund, the participation of civil society and business associations in the development of public policy reforms has dramatically increased. These fundamental cultural changes in the relationship between the public and private sector is only possible because of the Administrative Code and PSI's continued advocacy for better implementation. The transparency and decision-making provisions of the Code are integral in convincing and forcing government agencies to give civil society groups a role in policy-making. The ongoing work of the Coalition in providing independent oversight of the administration of the Code is a good example of how NGOs can serve the interests of society in a way that government agencies cannot.

Sustaining Democracy in the Developing World:

The Economic and Social Conditions for Democratic Consolidation

*Andrew Richards,
Center for Advanced Study in the Social Sciences
Juan March Institute, Madrid, Spain*

A major conference on Democratic Transition and Consolidation, jointly organised by the Fundación para las Relaciones Internacionales y el Diálogo Exterior (FRIDE) and the Gorbachev Foundation of North America was held in Madrid from 19 to 27 October 2001. It was attended by over thirty heads and former heads of state and government, and one hundred practitioners and experts in the field of democratic transition. This article synthesises the findings of the conference with respect to the economic and social conditions necessary for the consolidation of democracy in the developing world.¹

The Key Issues

The evidence showing that democracy is compatible with the market and with the economic efficiency is overwhelming. Yet, new democracies have generally been established in hard times. The international context in which these democracies have operated has been globalized (both in terms of trade openness and liberalization of capital flows). Overall, economic growth has been limited (the average growth rate over the last twenty years has been halved since 1973), job creation has been slow, and income inequalities have grown. Even allowing

for variation between countries, the consequences of globalization for many developing democracies have been almost entirely negative. Given continuing significant levels of protectionism in the developed world, the opening up of developing democracies' markets to foreign competition has damaged their national production and balance of payments. Market reforms and economic adjustment measures failed to help the poor. On the contrary, a consensus emerged regarding the negative impact of reforms and economic adjustment measures on levels of poverty, unemployment, inequality and support for democracy.

Yet, evidence demonstrates that the democracies which have higher levels of development and economic growth are more stable. Also, an equal income distribution leads to democratic stability. Economic and social conditions therefore have considerable influence on whether new democratic regimes can last and function effectively.

Until economic and social policies change, the living conditions of the poor in the developing democracies and the danger of political destabilization will persist. The key conclusion of the conference was that for the

consolidation of democracy, economic and social policies must be directed towards equitable development. Macroeconomic adjustment by itself is not sufficient. Social considerations cannot be isolated and separated from the goal of economic growth. Economic development is compatible with redistribution - indeed, such policies can aid economic development.

Nobody questioned, however, the need for rigorous macroeconomic management. Protectionism was rejected overwhelmingly in favour of the need to attract foreign investment as the motor for economic growth. In the context of globalisation, the ability of national governments to dictate macroeconomic policies is severely limited by the markets, while attempts to go against the markets can only result in disastrous economic destabilization. Furthermore, the policies contained in the *Washington Consensus* were accepted as necessary conditions for sound macroeconomic management. Economic stability (the control of inflation, the budget and the current account) and the establishment of stable norms (that are compatible both with the maintenance of investors' confidence and the democratic alternation of political power) are critical.

Economic and Social Conditions for Democratic Consolidation Panel

Moderator: His Excellency José María Figueres (Costa Rica)

Coordinator: José María Maravall (Spain)

Assistant to Coordinator: Andrew Richards (Spain)

Members of Group:

Thomas Biersteker (USA)
 Javier Corrales (Puerto Rico)
 M.A. Ordóñez Fernández (Spain)
 Grzegorz Kolodko (Poland)
 Hermelinda Meksi (Albania)
 Joan Nelson (USA)
 Adam Przeworski (Poland)
 Rahardi Ramelan (Indonesia)
 Barbara Stallings (USA)
 Juan Carlos Torre (Argentina)

Nonetheless, while macroeconomic stability, trade liberalization and regulated forms of privatisation are necessary policies for the achievement of sustained economic growth, they are insufficient. If economic and social policies are to be directed towards equitable development, the two most critical issues are how to organise public revenues and how to reorient public expenditures towards this goal.

Organising Public Revenues

Democratic governments in the developing countries have to generate attractive conditions for foreign investment. First, this involves the construction from scratch (especially in the post-Communist countries) of new institutions, such as stock exchanges, investment banks, security control commissions, investment funds, trade and tax codes, competition and anti-trust laws. Also, in the poorest countries, it involves the establishment of fundamental components of the state apparatus such as a Ministry of Economy. International financial institutions should play a key advisory role in the construction of this new institutional context.

Second, the prior establishment of appropriate institutions for privatisation

and trade liberalization is fundamental for an orderly and effective process of economic development. Economic reforms must be pursued in a given sequence. The market determination of exchange and interest rates must come before trade liberalization and privatisation. The abolition of barriers to competition and the establishment of anti-trust laws must precede changes in the structure of ownership.

A consensus emerged that economic failures are the result of reform initiatives not having followed the correct order. Privatisation, without proper regulation, can result in many negative externalities and negative fiscal effects. The liberalisation of capital markets and natural monopolies requires effective regulation in order to avoid economic abuses. Indeed, threats to an efficient market often stem not from too much, but from inadequate, regulation.

Third, if democratic governments in developing countries open their trade, their agricultural products must have access to the markets of the industrialised countries. The opening of the latter's markets to the products of the developing world is essential. Yet the value of protectionist measures for agricultural production in the industrialised countries currently exceeds by 50% the value of total external aid to developing countries.

Fourth, democratic governments in developing countries must achieve low inflation and control fiscal and current account deficits. Only with macroeconomic stability will a government gain room for manoeuvres with which to pursue its policy preferences.

Fifth, governments must increase savings rates, including tax reforms to encourage retained earnings by companies, and improve the operation of factor markets.

Democratic governments must utilize the state to promote growth. Heads and former heads of state and government called for the rapid establishment of a "new" *Washington Consensus* which should include an active role for the state in the generation of economic growth. Within the general framework of

sound macroeconomic management, there is a huge variation between countries with respect to levels of public revenues and expenditure, the proportion of the budget dedicated to social policies, the balance between investment and consumption, and the degree of economic centralisation. The critical issue is that structural economic reforms should not constrain the capacity of the state as an instrument of growth. For this to be effective and transparent, the state bureaucracy must be competent, honest and accountable.

If this is achieved, governments must then restructure public expenditure from investing in non-competitive industries to investing in human capital, infrastructures, and labour market policies. They must promote exports, which depends on investing in communications, energy and transportation. The state can also help in reaching external markets with information, products and technology. Governments must create links between large and small firms, to increase the productivity of the latter, and must strive to form productive private-public partnerships. Finally, they must ensure that market rules and regulations are transparent and predictable.²

In sum, heads and former heads of state and government, from both Europe and Latin America, emphasised the critical role of the state via public spending in generating growth and economic redistribution, and maintaining social cohesion. Only the state can foment, efficiently as well as the physical and human capital, and develop the legal framework for economic activities.

Public spending on education should be directed towards primary and secondary levels; public spending on health should be directed towards prevention and primary care; food subsidies should enable 1,200 million people to work rather than merely survive. At the same time, the state has the responsibility to promote active policies of job creation, and of education and training to prevent frictional unemployment from becoming structural in nature.

Reorienting Public Expenditures

Democratic governments must develop the fiscal resources with which to promote growth. In general, the fiscal resources of developing democracies are severely limited. In the former Communist countries, fiscal systems have had to be reconstructed, while in the poorest developing democracies, the short-term possibilities for doing so are constrained; their state expenditures have to be based largely on external aid. In other new developing democracies, governments have inherited very limited public revenues and expenditures. These are very unequal: higher taxes are not related to higher income, while lower income groups do not benefit more from public expenditure. In authoritarian conditions, revenues depended on state intervention (via tariffs, licensing fees etc.), on the export of high-value resources and on the complicity between the state and key interest groups. As a result, in most new developing democracies, income tax represents less than 15% of public revenues.

Given this adverse context, the design of new fiscal systems includes several components. First, it is a political battle. Entrenched interests, as the previous beneficiaries of privileges, will attempt to sabotage fiscal reforms. On the other hand, taxpayers may reject taxes if they have no confidence in the capacity and fairness of the state. A democratic government can only appeal to the population against entrenched resistance if it provides greater political accountability and is willing to accept monitoring in exchange for greater revenues, and if it introduces changes in public spending to correspond to social demands.

Second, there must be sufficient fiscal resources for macroeconomic stability. If they are to be an effective economic instrument, public revenues must be sufficient, and must be able to meet development needs such as adequate investment in education and training, infrastructure and labour market policies.

Third, fiscal reform involves several changes to the tax system:

- broadening the tax base
- streamlining and simplifying the tax system (the more complex it is, the more difficult it is to administer and the greater the likelihood of tax evasion)
- establishing moderate tax rates, with a minimal number of exemptions
- stabilising the tax rates and fiscal structure in order to enhance predictability for economic decisions
- balancing direct and indirect taxation, whereby tax evasion is made more difficult, and decisions on investment, production and employment are less distorted
- making customs collection more transparent
- enforcing corporate taxes
- taxing some financial transactions
- avoiding "one-shot" revenues from privatisations as a substitute for fiscal revenues
- establishing fiscal federalism if a country is politically decentralised, and not just transferring public expenditure to regional and local authorities (which results in fiscal irresponsibility)
- ensuring that in conditions of fiscal federalism, a system of territorial transfers is established to redistribute income from rich to poor regions.

Fourth, fiscal sufficiency must be the criterion for taxation - that is, redistribution should be the task of public expenditures rather than of taxation.

Fifth, the economic consequences of taxation cannot be separated from those of the public expenditures that they finance. Thus if taxes contribute to public expenditure on productive inputs, private investment can increase and higher growth rates can result.

Sixth, available evidence for OECD countries shows that tax rates have no effect on savings, investment, the supply of and demand for labour, or on economic growth. Investors are far more concerned with political and macroeconomic stability (including the absence of fiscal deficits), and the

predictability of tax rules, than about the level of fiscal pressure.

Seventh, the effect of globalisation on foreign investment is inconclusive. Negative reactions to tax rates are more likely, in fact, among domestic investors than among foreign ones.

Economic Growth and Redistribution

Democratic governments do not face a "cruel choice" between economic efficiency and the redistribution of assets and income. The relationship between economic growth and redistribution is hotly debated amongst both politicians and academics. On one hand, it is often argued that the redistribution of assets and consumption misallocates productive resources, decreases aggregate savings and thus investment. On the other hand, it is also claimed that greater equality enhances efficiency, improving the use of human resources, fostering public and private savings and expanding public support for economic reforms. Is economic growth therefore promoted or eroded by redistribution?

First, in the case of productive assets that generate diminishing returns, a more egalitarian distribution can lead to greater economic output. But redistribution can only be implemented by the state, as credit markets for such assets are missing because borrowers cannot credibly commit the productive use of loans. The cost of redistribution is lower if it consists of lump-sum transfers (that is, a land reform, or a one-time levy to construct schools).

Second, resources that increase the productivity of physical and human capital must be considered as investment. Public education increases the productivity of the poor, and generates high returns, as it contributes to growth and to income equality over the life cycle. Public expenditure on health also enhances the productivity of the labour force. Food subsidies reduce poverty: for example, the World Bank reports that micronutrient malnutrition can cost a country 5% of GDP, while redressing it can cost less than 0.3%.

Third, the argument that a redistribution of consumption increases the value of leisure, and thus reduces

the supply of labour, is unconvincing. Econometric studies have shown that taxes that finance transfers lead to higher growth, and that a guaranteed minimum wage has no effect on unemployment. In addition, the debate on the consequences of labour market rigidities on employment is not conclusive. Experts at the conference viewed deregulation, as well as decentralised wage negotiations, as essential for job creation, while some others argued, on the basis of econometric evidence, that labour market rigidities do not have consequences for employment levels.

Fourth, one way of improving the quality of jobs is to focus on where jobs are actually being created. As the main source of job creation in developing countries, small and medium enterprises must have better access to finance and technology, and better links with large firms. Micro-firms have fewer chances for improving the quality of jobs, and workers should be gradually incorporated into other parts of the economy. A large informal sector is prominent in many developing new democracies. While this sector must be gradually incorporated into the "formal" economy (for instance, in order to avoid exploitation and improve working conditions), it can also be the site of entrepreneurial initiatives, and can contribute to the profitability of formal businesses via the provision of small or specific orders. Nor does the informal sector necessarily cause a loss of taxes, because it generates income and therefore effective demand. It also provides a significant role in alleviating hardship, providing a "partial safety net".

Fifth, if public resources are limited, protection from need must depend on targeted social safety nets, rather than on citizenship-based welfare policies, as the former is more efficient economically. Targeting is different from means-testing, and must avoid the social stigmatisation usually associated with the receipt of benefits. It may, however, be difficult to administer, politically complicated and socially divisive. Rather than targeting households, redistributive programs can be directed to the welfare of socio-economic groups or geographical areas (for example, providing them with roads, transport, telecommunications,

schools and clinics). Protection from need must be integrated into policies of development that include job creation and economic competitiveness.

Sixth, if growth and redistribution are to be combined, public revenues must be reallocated to different social programs. In education, greater resources must be redirected from the university to the secondary levels in general, and to the poorest sectors in particular. In health, academic experts concur that priority should be shifted decisively to primary and preventative care (compared to the construction of large hospitals, for example, which are expensive and less concerned with general health coverage). Free access to social welfare provision need not be guaranteed to higher income groups, because it is too costly.

Seventh, decentralisation of social services should be limited to management and not extend to finance and policies, otherwise the poorest areas will receive the poorest services.

Eighth, the relationship between the level of social expenditures (as a percentage of GDP) and its distributive consequences is not a direct one. It is mediated by its form of allocation and implementation. Even with limited resources, much can be done to attend to material needs and fight poverty, thereby helping new democracies to survive and function.

Sustaining Democracy in the Poorest Countries

Democratic governments in the world's poorest countries face particularly acute problems and challenges. As a result, general prescriptions for economic reform and development need to be adapted to their specific circumstances. These countries do not, in general, attract foreign investment, they have limited participation in international trade, and are not integrated into the world economy. Their problems, therefore, do not stem from the globalisation of their economies.

Yet, democratic governments in the poorest countries can only achieve a minimum level of autonomy if they receive external aid. The latter can

be effective in promoting growth only to the extent that certain domestic conditions have been established: reasonable political stability and progress towards the rule of law (including enforceable contracts); political accountability and administrative transparency; rigorous and responsible macroeconomic policies; a combination of competent public agencies and a legal framework that permits private firms and non-profit organisations to deliver basic services to the public.

At the same time, though, some external conditions have also to be modified, including the overhaul of existing international financial institutions (see below) and the means by which external aid is monitored.

When such domestic and external conditions are met, the debt of poor countries must be written off without additional conditions - it is not realistic to expect its repayment, and servicing it leaves governments with no economic resources. However, new lending must be based on standard approaches to conditionality.

For the poorest countries, heads and former heads of state and government agreed that minimalist programs based on the most pressing economic and social needs are the only feasible option. Mostly financed by external aid, they again imply a crucial role for the state, in the form of fine-grained interventions, by region or sector, designed to promote pro-poor economic development. They respond, moreover, to political and financial realities: in the short term, they benefit the poor, do not diminish income needed for investment, increase the productivity of workers, and may improve regional infrastructures.

Finally, the experiences of new democracies with respect to NAFTA, ASEAN and the EU demonstrate, for the poorest countries, the potential benefits of regional integration for trade and development.

Overhauling International Institutions

In the course of their deliberations, heads and former heads of state and government concurred that existing international institutions are inadequate with respect to the need for economic growth in the new and developing democracies. All agreed that reform of the external institutional context is critical, and reiterated the experts' conclusions that the industrialised countries must fulfil their commitment to dedicate 0.7% of their GDP to external aid, and that the debt of the poorest countries, in keeping with the conditions described earlier, should be written off.

In addition, though, they argued that the injection of foreign capital, both in the form of external aid and foreign investment, must be increased in order to finance economic growth. As such, a new round of WTO trade negotiations, in which the interests of the developing countries are the priority, is essential. Furthermore, economic globalisation requires new international institutions of economic administration. One participant argued that the current Breton Woods institutions are incapable of foreseeing economic needs and preventing economic crises. Representatives of the poorest countries complained that economic growth was never a theme in negotiations with the IMF.

In sum, participants in the conference agreed on the urgent need for the reconstruction of the IMF, World Bank and WTO and, more importantly, for the creation of new institutions. One proposal centred on the creation, within the United Nations, of a council for economic and social development. But above all, it was agreed that alliances between democracies should not just be the result of external threat, or be fundamentally of a military nature. Instead, they should respond to the urgent needs of economic growth and the material welfare of the people in the new democracies.

(Footnotes)

¹ It draws exclusively on, and in places directly from, the reports of (1) the working group of experts on Economic and Social Conditions, and (2) the subsequent deliberations of heads and former heads of state and government with respect to the experts' report. Both sessions were moderated at the conference by José María Figueres (former President of Costa Rica) and coordinated by José María Maravall (Academic Director, Center for Advanced Study in the Social Sciences, Juan March Institute, Madrid, Professor of Sociology, Complutense University of Madrid, and Spanish Minister of Education, 1982-1988). The reports were elaborated by José María Maravall, with my assistance. For access to the full versions of these two reports, to the reports of all working groups, and to general information on the conference, its participants and its proceedings, see FRIDE's web page at: www.fride.org

² In the deliberations of the heads and former heads of state and government, one participant argued for the importance of "social capital" in the generation of economic growth. Social capital (the conceptual and explanatory value of which is hotly contested in the social sciences) is understood as "civic virtue" whereby citizens obey the law, pay their taxes and create networks of trust. Social capital is created by both the state (through the education system) and civil society (through the activities of the church, political parties etc.). It has been argued that differences in levels of economic development between Latin America and South-East Asia can be attributed to variations in levels of social capital.



Center for International Private Enterprise
1155 15th Street NW
Suite 700
Washington DC 20005
USA