

Economics and Politics of Transition

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**Paper prepared for the Mont Pelerin Society Special Regional Meeting,
Sri Lanka, January 10-15, 2004**

Economic reform became a global phenomenon in the last quarter of the twentieth century. It took the form of widespread policy changes to stabilise and liberalise economies. Countries in every geographic region, including China, other Asian countries, India, Western and Eastern Europe, the former Soviet Union, North and South America and Australia and New Zealand, were part of this process. The Fraser Institute's Economic Freedom of the World project documents moves towards greater economic freedom in all but a small group of countries. The latest report indicates that these trends are continuing, albeit slowly.

In that period, what David Henderson has called a "semi-consensus" formed within the economics profession and more broadly:

... a growing belief that economic performance had suffered as a result of the increase in regulation, the malfunctioning of public enterprises, the rise in public expenditures and taxation rates, the failure to curb inflation or to bring down fiscal deficits, and the growth of trade union power. [3]

These conclusions have led scholars to emphasise two central themes in writings on economic development.

The first is the need for sound institutions and policies. [4] By (formal) institutions is meant such things as the rule of law, respect for property rights, an independent judiciary, democratic government and a free press. Roll and Talbott have found that good institutions and policies account for as much as 85 percent of the international variation in income per capita. [5] Informal institutions – such as values, customs and work habits – are also very important.

The second theme is the importance of a high level of economic freedom for prosperity. Freedom to enter and compete in markets promotes efficiency by directing resources to their highest valued uses. Even more importantly, it facilitates entrepreneurship and innovation. The Fraser Institute indexes also point to positive relationships between economic freedom and poverty alleviation, life expectancy and reductions in income inequality. And of course economic freedom is a value in its own right.

Yet even if history is on the side of democratic capitalism, as Francis Fukuyama has argued, and central planning, import substitution and Keynesian demand management policies – ideas that were to the fore in 'development economics' only a quarter of a century ago – are largely discredited, anti-liberal beliefs are still widely held and influential. Socialism retains deep roots in Central and South America, the momentum of economic liberalisation has fallen away in many Organisation for Economic Cooperation and Development (OECD) countries, reforms implemented in response to economic crises in Asia and Russia have only been partial, and large parts of Africa and the Islamic world are still characterised by an absence of democracy and free markets. Although much has been learned about the economics of transition, the political challenges facing liberal reformers remain formidable in many countries. Many of them are specific as to time and place; it is difficult to generalise about political strategies for achieving liberal reforms. Nevertheless, experience points to some issues that are worth exploring.

Democracy versus authoritarianism

Recognising the power of entrenched ideas and of interest groups resistant to liberal economic reforms, and the pain and upheaval associated with transitions, some are tempted to embrace authoritarian strategies. They subscribe to democratic politics as an end goal, but 'democracy can wait'. 'We need a Pinochet' is the common expression of this view, or at least a Lee Kuan Yew. Others point to the more benign experience of Hong Kong which achieved prosperity through the rule of law and economic freedom before it enjoyed any democratic freedoms. The different paths followed by China and Russia have been seen by many as a case study, and Chinese leaders have openly derided the path taken by Russia. As Deng Xiaoping put it:

[Gorbachev]'s got it backwards. He opened up the political system without a clue about the economy. The result is chaos. I did it the other way around, starting in agriculture and small businesses, where opening up worked, so now I have a demand for more of what succeeds. [Political opening] will come later and will start small, just as in the economy. You have to be patient but you have to get the sequence right. [6]

When one thinks of the enormous difficulties of establishing a functioning democracy in a country like Iraq after years of authoritarian rule, the Chinese path must appear seductive to many. History also provides many examples of countries that moved in a democratic direction only to suffer a relapse into authoritarianism within a few years. Zakaria cites evidence to suggest that the probability of such relapses is highest for poor countries; once per capita incomes approach the middle ranges, the death rate for newly born democratic regimes falls sharply. [7] Democracy only seems generally secure once an educated and propertied middle class that aspires to civil rights and the rule of law is established.

Yet tempting as the notion of an authoritarian route to prosperity may be, the empirical reality is that authoritarian success stories are very much the exception rather than the rule. Pinochet's Chile is unique in Latin America; the pattern in Africa is of despotic poverty. The modern economic era began in England and spread in the West when feudal, monarchical and authoritarian regimes gave way to the first forms of democracy and the rule of law. There is no law which says that authoritarian regimes cannot achieve material prosperity, at least for a while. However, the track record is not good, and in public policy it is unwise to bet against the odds.

There seem to be two related reasons why democratic societies generally outperform authoritarian ones over the long run.

The first is that they handle the problem of succession better. Normally, one democratic government peacefully replaces its predecessor. Moreover, it is a good feature of democracies that different political parties periodically attain office; it means that important groups of voters do not feel permanently disenfranchised. The problem with authoritarian government is what happens when the despot dies or the ruling clique is toppled; often the outcome is chaos.

The second reason why democracies have generally fared best is that property rights and the rule of law tend to be better respected in such societies. Authoritarian regimes are typically predatory, even though there may be limits to their predation, as Olson has suggested. In such regimes the incentives for investment and long-term planning associated with strong property rights are absent or weak. [8]

Ultimately, the Deng Xiaoping proposition reflects the fatal conceit of socialist constructivism. As the Russian reformer Yegor Gaidar put it on a visit to New Zealand in 2000:

This argument betrays a strange understanding of practical life. It is as though one is sitting in a restaurant, choosing from a menu, and wondering: 'Do I want the steak well done

or medium?' 'Should I have political liberalisation after market reforms or before' – as though this were a problem of choice. It is as though in New Zealand you were confronted with some difficult economic problems, and somebody said: 'The totalitarian regime has its advantages. Let us introduce it for a time. Then, when we solve our economic problems, we can turn back to democracy'. A nice idea, but no intelligent political architect would want to implement it. [9]

Gaidar adds that what worked in China in the 1970s with a largely uneducated population, most of which was engaged in agriculture, could not have worked in the richer, better educated and industrialised Soviet Union that had practised socialism for three generations. Moreover, choosing the authoritarian path requires a willingness to countenance a Tiananmen Square massacre or its Chilean equivalent. And while Chile has engineered a transition to democracy, the jury is still out on China .

My conclusion is that while democratic politics is often messy and fractious, and not a surefire route to economic development, its record overall is better than the alternatives. [10] As Gaidar's comments suggest, the debate about political transitions seems to me to have many of the same artificial features as the debate about policy sequencing in an economic transition. Societies have to find their own way to both democracy and capitalism: the values and traditions underpinning them cannot be imposed from the outside, nor is there a universal golden rule that is independent of a country's history and state of development. However, the historical record "provides little support for any general claim that a need for economic reform provides a respectable excuse for suppressing or postponing democracy." [11] There are grounds for optimism about countries that have liberalised politically as well as economically, even though economic progress has sometimes been slower. India has come a long way since the days of Nehru's socialism, and the Indian tortoise could yet overtake the Chinese hare. The prospects for the eventual success of democracy in some other developing countries, including Sri Lanka , are promising too. And material success is not everything; political freedom is also a value in its own right.

Voting systems and economic constitutions

Without going into a discussion of the design of a democratic system, a couple of issues may be worth noting.

An important element of democracy is the voting system a country chooses. This seems to have been given relatively little attention by liberal scholars. They tend to stop at advocating the case for limited government – government limited to its core roles of ensuring the provision of genuine public goods and a minimum safety net.

Their advice about government is similar to Smokey the Bear's rules for fire safety: 'Keep it small, keep it in a confined area, and keep an eye on it'. Relative to this goal, they tend to regard institutional choices – federal versus unitary systems, bicameral versus unicameral legislatures, proportional versus first-past-the-post voting systems and the like – as second order considerations. But this begs the question of what democratic arrangements are most likely to be conducive to limited government.

Karl Popper is one scholar who has discussed voting systems. His claim is that what is most important for democracy is the ability of the electorate to throw out a government it dislikes. Popper concludes that on this criterion first-past-the-post (FPP) systems score best. Under FPP systems, an incumbent government can be decisively voted out; with proportional representation (PR), coalitions may just be rearranged with minor adjustments. In Europe , for example, it is precisely the countries with PR systems in which political parties or coalitions have been continuously in power over long periods that the worst cases of corruption have developed: Italy is the leading case, but Austria too has suffered. While the *processes* of PR systems appear more representative, the *outcomes* may be less representative of what voters want. PR systems also give more power to central parties and they are less accountable to the electorate, given the post-election negotiations and compromises that are needed to form and run governments. The experience of New Zealand, which moved from an FPP system to

a German-style proportional representation system in 1996, is that coalition government is conducive to higher spending (as parties do deals to favour particular constituencies at the expense of the taxpayer), to reform paralysis and to lower quality policy decisions as a result of inter-party compromises. However, the winner-take-all nature of FPP systems may not suit the social make-up of some countries, at least at the national level – a current case in point may be Iraq . Here a large measure of decentralisation and regional governance based on ethnic/religious divisions may be indicated. Another remedy in appropriate settings may be direct democracy. This is naturally popular, but referenda are typically disliked and vetoed by the political class, which often constitutes a cartel against reform.

A second issue is the use of constitutional rules to constrain government. The motivation for such rules is the public choice insight that governments commonly opt for short-term and partisan policies rather than ones that reflect long-term national interests. Short of a full-scale constitution along US lines, one option is to constrain important areas of economic policy with quasi-constitutional rules. The most straightforward is monetary policy, where New Zealand was the first country to make the implementation of monetary policy independent of executive government and give its central bank an explicit mandate to achieve price stability. This was followed in New Zealand by a form of 'fiscal constitution' whereby the government is required to establish long-term objectives for variables such as expenditure, the operating balance and public debt, report semi-annually and before elections on the state of its accounts, and explain departures from its goals and planned remedial action. A third idea being canvassed is a regulatory constitution, a central feature of which would be a requirement for compensation in the event of regulatory takings.

My sense is that there is an unfinished research agenda for liberal scholars on the design of democratic arrangements most conducive to limited government, individual freedoms and free markets.

Igniting reform

I consider next the issue of igniting liberal reforms. Why is it that some countries have embarked on radical economic liberalisation while others have stuck with the failed policies listed by David Henderson, or with still more repressive economic systems? And perhaps an even harder question is: How does a country sustain a reform programme, or reignite one that has stalled?

A common answer to the first question is, of course, crisis, war or some form of external threat. Countries in situations as different as Chile , Britain , New Zealand , Ireland and the Soviet Union fit into the first category; Germany , Italy , Japan , Taiwan and South Korea fit the second. In many of these cases, Olson's thesis about the tendency of countries enjoying long periods of stability to become sclerotic under the influence of powerful interest groups has resonance. [12] Disruptions such as economic crisis or war can disempower established interests, force a national stocktaking and facilitate political change and new policy directions. The worst of times can give rise to the best of opportunities for radical change. [13]

Often the new directions are liberal because interventionist or even more repressive policies have been tested to destruction: such was the case in the Soviet Union and New Zealand . But there are counter-examples of anti-liberal responses to crises: Malaysia and Argentina are recent cases in point. Much depends on local circumstances.

Why do countries get to a point where only a crisis can ignite liberal reforms? One banal but nevertheless valid explanation is the human aversion to change. While some people, particularly in younger age groups, like the opportunities that change offers, others prefer to cling to old ways and soon complain about 'reform fatigue'. Another is the power of mistaken ideas, whether ideological or pragmatic. Much wrongheaded economic thinking stems from mistaken conceptions of social organisation, such as an urge to extend the habits of resource-sharing in families or tribes to the wider society, or to invoke a 'visible hand' to remedy an obvious problem in a direct and apparently commonsensical way. The liberal conception of an economy that is coordinated without conscious central direction is not easy to grasp. A further obstacle to change already mentioned is the ability of interest groups to use the political process to advance private rather than public goals. Sometimes only long

experience with the results of bad policies or the evidence of better results elsewhere triggers a willingness to change.

Nevertheless, it would be an unfortunate state of affairs if crises were the only possible catalyst for change. There is reason to be more optimistic: Australia is an example of a country where a long period of underperformance well short of a crisis, combined with a changing climate of ideas, produced a major change in direction from the early 1980s. The US policy changes in the Reagan era were another case in point. A belief in reason and the ability of people to learn from experience suggests that democratic societies have the potential to self-correct and make better collective decisions. Ideas matter – indeed Keynes perhaps got one thing right in suggesting the world was ruled by little else – and there is evidence that electors can make good choices when ideas are put before them fully, simply and intelligently. There is a deep well of realism and common sense among the ordinary people of any community, and a willingness to look beyond the short term if properly informed.

This conclusion points to the crucial role of the institutions in our societies that generate and communicate ideas – universities, think tanks, the political class and the media. The continuing refinement and exposition of liberal ideas through research and scholarship is a vital starting point. No less important is the transmission of ideas through society's communications agents. Here politicians have an indispensable part to play. Without political leadership, entrepreneurship, skill and stamina, the task of igniting reform and, particularly, of sustaining it, becomes extremely difficult. It is hard to compensate for weaknesses in the political sphere in other ways.

I turn now to the politics of implementing a liberal reform programme.

Implementing liberal reforms

Much has been written over the past 15 years on the lessons of managing transition. Economists have discussed issues such as the relationships between stabilisation and liberalisation, the optimal sequencing of policy reforms, and the respective merits of shock therapy and gradualism. Some of this is insightful, but too often it abstracts from country circumstances and political realities. Of course it would have been better if the incoming Labour government in New Zealand in 1984 had moved fast to free up the labour market, but given that it was elected on a platform which included a commitment to reverse its predecessor's move to introduce voluntary trade unionism, that wasn't going to happen. Did that constraint mean that it shouldn't have embarked on other wide-ranging liberalisation moves? No. Could it have done more to overcome political obstacles to labour market reform during its time in office? Yes. Eventually comprehensive changes to labour law required a change of government, as the electorate came to understand that the reform programme could not be coherent and successful without them. As with political liberalisation, moves towards economic liberalisation are constrained in practice. The most important considerations are to set a clear direction, maintain momentum, and achieve a coherent overall economic framework over time.

I shall put to one side the more technocratic literature on the economics of transition and focus on what I see as more general political lessons. They may provide useful insights, even if they do not amount to a blueprint for all reformers in all circumstances.

• *The importance of vision*

In an important passage in *The Intellectuals and Socialism*, Hayek wrote:

The main lesson which the true liberal must learn from the success of the socialists is that it was their courage to be Utopian which gave them the support of the intellectuals and therefore an influence on public opinion which is daily making possible what only recently seemed utterly remote. [14]

The liberal vision of a just and prosperous society is attractive and inspiring and deserves to be articulated with conviction. The evidence of the benefits of economic freedom is now incontrovertible; this could not have been so confidently asserted even a generation or two ago. More prosaically, people need to know where a reforming government is leading them so that they can plan and adjust. They need to understand why short-term costs and disruption are an inevitable part of a structural reform programme aimed at long-term gain. And they need to be reminded constantly of the vision and plan. Ludwig Erhard was just one of many reformers who understood the necessity of endless communication.

- ***How consensus occurs***

Margaret Thatcher once said:

To me consensus seems to be: the process of abandoning all beliefs, principles, values and policies in search of something in which no one believes, but to which no one objects; the process of avoiding the very issues that have to be solved, merely because you cannot get agreement on the way ahead. What great cause would have been fought and won under the banner "I stand for consensus"? [15]

There is a characteristic element of dogmatism in these remarks, but also a large element of truth. There is no invisible hand in politics; politics has to be practised by visible leaders. In politics as in business, individuals can make a big difference. Reform leadership often means getting ahead of public opinion, but reforms cannot just be rammed down people's throats. Frequently, consensus cannot be won in advance of reforms but is secured by the results. "If reformers succeed, a social consensus will form in support of their measures; if they fail, no amount of prior social consensus will save them from being cast aside." [16] Privatisation is an example of a policy that is controversial in most countries – socialist attachment to public ownership dies hard. Generally, it did not attract support in advance but on balance it has been hugely successful and seldom reversed – facts overtook the debate. However, consensus is necessary to sustain ongoing reform. Ireland and Australia are countries that have achieved a high level of consensus around a reform programme. This has helped their governments to maintain a generally stable and consistent reform path which has been positive for investment and growth. New Zealand, for various reasons (among which have been promise-breaking by successive governments), has enjoyed a lower level of consensus, and hence less stability and economic success.

- ***The value of high quality decisions***

There is a high political premium on high quality reforms wherever they can be implemented. Achieving the best possible outcome is usually difficult, but spending political capital up-front is often less costly than making compromises that deliver inferior results, or having to wage successive battles to achieve a desired end-goal. Thus the introduction of a value-added-based goods and services tax in New Zealand on a broad base and at a single rate was highly controversial, but within a couple of years it was widely accepted and no longer a political issue. By contrast, rounds of piecemeal reforms in education and health in New Zealand were politically debilitating as interest groups fought repeated battles. Changes in these areas are widely seen as less successful, and they remain controversial. Where reforms have to be staged, as in the case of trade liberalisation, it is important to maintain the momentum of change and a consistent programme in order to achieve credibility and sustain investment confidence.

- ***The value of broad-based adjustments***

Adopting a liberal programme can be easier if it is pursued on a broad front. From an economic perspective, structural adjustments in some markets (eg those for goods and services) are facilitated if other markets (eg the market for labour) are being freed up

simultaneously. From a political perspective, broad-based reforms can result in a more even sharing of the burdens and benefits of adjustment, reduce the need for specific adjustment assistance, disarm interest group resistance and deliver earlier benefits. Opening up an economy tends to weaken the power of distributional coalitions. As firms and unions become more exposed to competitive pressures, they tend to be more critical of government action to shield other groups from competition. For similar reasons, speed and urgency may be preferred to gradualism. Against these factors must be weighed the capacity of a government and its executive agencies to implement an ambitious reform programme, and the risk of setbacks if it is not executed well. Administrative capability is often lacking in poorer countries. This is another reason for favouring a minimum of government control and regulation: inevitably big government breeds incompetence and corruption. [17]

- ***Addressing issues of fairness***

In New Zealand, opponents of the reforms would often grudgingly accept that they had produced a more efficient economy, but complain about a 'fairness deficit'. In reality, earlier policies were often grossly unfair as well as inefficient: inflation hurt those on low fixed incomes, government borrowing passed debts to future generations, barriers to labour market participation penalised those with low skills most, taxpayer subsidies to higher education were a transfer from poorer to richer groups, and so on. Liberal policies typically score better than socialistic policies on grounds of fairness as well as on other grounds, but often anti-liberals have had a monopoly on fairness arguments, many of which do not withstand scrutiny. Economic freedom provides ordinary people with opportunities for employment, and for personal and business initiatives, that are a powerful means of social advancement. It is not only through government intervention that goals of equity and social justice are best pursued. More emphasis should be placed on fairness, and indeed on moral arguments generally, in making the case for liberal reforms.

Reformers should not pretend that an economic liberalisation programme can be free of casualties. In the interests of fairness and of enhancing community acceptance of the programme, attention should be paid to minimising hardship. This involves strategies such as parallel dismantling of privileges, removing obstacles to retraining and employment, ensuring adequate safety nets are in place and, where property rights are altered in the public interest, paying compensation. It takes time to rebuild the institutions of civil society which often do a better job of caring for people in need than government welfare programmes.

- ***Rehabilitating the vocation of politics***

Almost universally, contemporary politics has got a bad name. The over-reach and failure of socialism has left people disillusioned. Younger generations are turned off politics. People associate politicians with corruption, demagoguery, promise-breaking and worse.

Yet we need politicians and political processes to discharge the core functions of government that are indispensable in a free society. Attracting good people into politics by ensuring adequate pay and other conditions of service is only part of the story. We need a broader national conversation. Liberals can convincingly argue that the status of politics would be improved if politicians refrained from over-reach and the inevitable disappointment it brings. It is no accident that America's first four presidents, who understood the meaning of limited government, are among its most admired. Politicians would gain in respect if they showed a greater commitment to ensuring that voters get to spend the fruits of economic reform themselves, rather than spending them on their behalf. A stronger fiscal constitution could help here. For their part, politicians should ask themselves the question posed by Roger Douglas, the main architect of New Zealand's initial reform programme: 'Why am I in politics?' [18] If the answer is to secure short-term popularity by supporting populist causes, or to enjoy the spoils of office, they are unlikely to rise in public esteem. Politicians who are remembered favourably by history are those who committed themselves to achieving changes that improved their nations' futures.

• *Leadership in the private sector*

Reforming governments need supportive constituencies. One of the most important potential constituencies, often neglected by liberal thinkers, is the business sector. Those who adopt public choice ideas literally tend to regard business as the enemy: an organised interest capable of blocking many desirable reforms. But public choice ideas can be pushed too far: if they were an iron law, how could any change occur? The business sector at large has a major stake in promoting a dynamic, capitalist economy. Businesses need a strong, competitive economy to achieve growth domestically, and as a platform to expand internationally. Capable business people are not short-term in their orientation – they strive to create firms that are 'built to last', and to maximise long-term shareholder value. These factors weigh against the natural tendency of businesses to defend privileges and engage in rent-seeking. Such tendencies can also be curbed if business views are mediated through broad-based representative business organisations that are forced to adopt wider and longer-term perspectives.

Liberal reformers and free-market think tanks should devote more effort to enlisting support from business. In part this requires education: commonly business people accustomed to hands-on direction of their firms do not easily comprehend the different basis on which a decentralised market economy operates. But business opinion has an important influence, for good or ill, on public opinion, partly because it is the sector from which most people draw their livelihood. In the former, inward-looking New Zealand economy, protectionist attitudes in business were an important force for harm. With changes of leadership in the business community, business at large is now a force for curbing political inclinations to reverse reforms and for keeping the arguments for resuming liberalisation before the public.

Conclusion

David Henderson has eloquently described the many anti-liberal influences that constrain the progress of economic liberalism in the world today. [19] Sometimes it seems that no sooner is one head of the socialist monster lopped off than it mutates and grows again. In recent times mutations have taken such forms such as anti-globalisation, environmentalist doomgearing (the Kyoto Protocol is the mother of all socialist schemes), false doctrines of corporate social responsibility, and post-modernist, deconstructionist and relativist notions in education. The future path of economic liberalism is likely to be long and tortuous, and history has a habit of turning back on itself at least for a time, as Henderson warns us.

Nevertheless, there are real grounds for hope. The dynamics of globalisation are forcing countries – other than the handful that have sealed themselves off for the time being from the world – to improve their institutions and policies in the interests of development. Socialist and welfarist programmes are giving way to liberalisation in response to international competition. Democracy and economic freedom are spreading. The communications revolution and improvements in literacy are putting information and modern technology in the hands of more and more people and increasing the demands for freedom – whether to vote or just to go shopping. Freedom and prosperity are likely to be the best antidotes to terrorism and religious fundamentalism.

The next 10 years are likely to see the performance gap between the Anglo-American models of capitalism on the one hand, and the social market welfare states of Europe and the corporatist interventionism of Japan on the other, grow wider. The pressures on Europe and Japan to liberalise can only mount. Then within another decade or two, China and India may start to rival the United States in economic weight in the world economy. Strange as it may seem given their histories, it is hard to see these countries moving towards bigger rather than smaller government. Instead they may lead the world in handing functions such as education, health and welfare over to the private sector, and becoming low-tax economies. If that scenario is matched by continuing progress towards political and civil freedoms in those countries, the prospects for liberal democracy and economic freedom in the world at large will be encouraging.

[1] Paper prepared for the Mont Pelerin Society Special Regional Meeting, Sri Lanka, January 10-15, 2004.

[2] Executive director, New Zealand Business Roundtable.

[3] Henderson, David (1999), *The Changing Fortunes of Economic Liberalism: Yesterday, Today and Tomorrow*, Institute of Public Affairs and New Zealand Business Roundtable, p 70.

[4] As Mancur Olson has put it:

... countries with the best policies and institutions achieve most of their potential, while other countries achieve only a tiny fraction of their potential income. ... The large differences in per capita income across countries cannot be explained by differences in access to the world's knowledge or to its capital markets, by differences in the quality of human capital or culture ... the only remaining plausible explanation is that the great differences in the wealth of nations are mainly due to differences in the quality of their institutions and economic policies.

Olson, Mancur Jr (1996), 'Big Bills Left on the Sidewalk: Why Some Nations are Rich, and Others Poor', *Journal of Economic Perspectives*, 10 (1) 3-22 p 19.

[5] Roll, Richard and John Talbott (2001), 'Why Many Developing Countries Just Aren't', Anderson School, University of California, Working Papers, www.anderson.ucla.edu and www.worlddevelopmentnow.com

[6] Deng Xiaoping to George Shultz, July 1998, quoted by Paul Monk in 'Hu's Challenges', *Australian Financial Review*, 31 October 2003.

[7] Zakaria, Fareed (2003), *The Future of Freedom: Illiberal Democracy at Home and Abroad*, W W Norton and Company, New York and London, chapter 2.

[8] "History does not provide even a single example of a long and uninterrupted sequence of absolute rulers who respected the property and contract-enforcement rights of their subjects." Olson, Mancur (2000), *Power and Prosperity: Outgrowing Communist and Capitalist Dictatorships*, Basic Books, New York, p 42.

[9] Gaidar, Yegor (2000), *The Struggle for a Free Economy and Society in Russia*, The Sir Ronald Trotter Lecture 2000, New Zealand Business Roundtable, Wellington.

[10] This is also the conclusion of Nobel laureate Douglass North, discussing poverty in Africa. He writes:

The main lesson is that no attempt at economic reform in Africa can hope to succeed if it ignores the concomitant need for political reform. Without attention to their political foundations, markets cannot flourish.

Haber, Stephen, Douglass C North and Barry R Weingast, (2003) *Wall Street Journal*, July 30.

It is also the view of Dani Rodrik:

I have shown ... that democracies perform better on a number of dimensions: they produce less randomness and volatility, they are better at managing shocks, and they yield distributional outcomes that are more desirable. One interpretation of these results, and the one that I have emphasized throughout, is that democracy helps build better institutions. While I am a great believer in institutional diversity, I see no argument that would make it appropriate for some governments to deny their citizens basic political rights such as freedom of speech, the right to vote and stand for political office, or freedom of association.

Rodrik, Dani (2002), 'Institutions for High-Quality Growth: What are They and How to Acquire Them', Working Paper 7540, National Bureau of Economic Research, Massachusetts, pp 21ff.

[11] Williamson, John (ed) (1994), *The Political Economy of Policy Reform*, Institute for International Economics, Washington, DC, pp568-569.

[12] Olson, Mancur (1982), *The Rise and Decline of Nations: Economic Growth, Stagflation and Social Rigidities*, Yale University Press, New Haven.

[13] See John Williamson, *op cit*, pp 562-565.

[14] Hayek, Friedrich (1949, 1998), *The Intellectuals and Socialism*, IEA Health and Welfare Unit,

p 26.

[15] Thatcher, Margaret (1995), *The Downing Street Years*, HarperCollins, p 167.

[16] Williamson, John, *op cit*, p 575.

[17] As Yegor Gaidar has put it:

If a country has an incorrupt bureaucracy it might be reasonable to discuss whether more regulation or less regulation is the better option. But for a variety of reasons, Russia does not have such a bureaucracy. Even with the best possible policy, it is unlikely to acquire this type of bureaucracy quickly – at least during the next decade. In these circumstances, discussions about introducing elaborate new regulations that give bureaucrats greater discretionary powers effectively constitute discussions about the quantity of bribes that will be extracted by the bureaucracy .

Op cit, p 29.

[18] Douglas, Roger (1990), 'The Politics of Successful Structural Reform', *Policy*, Autumn.

[19] Henderson, David, *op cit*.

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