Lost in transition

Democracy and the market economy are a peerless team as models of societal success. But it is no easy task to introduce them to a country for the first time. Efforts to do so often result in defective democracies. The challenges are complex. Relevant issues are, amongst other things, the distribution of wealth and income as well as cultural identities.

[By Michael Dauderstädt]

While even the last bastions of communism like China and Vietnam have apparently embraced the capitalist principles of the market economy, the third wave of democracy seems to be turning slowly into a tide of defective democracies (Merkel, 2004). Simultaneously, many countries have descended into anarchic conflict since 1989. For the people of such failed states, life is "cruel and brief" (Hobbes) and they almost long for the Leviathan state to establish social order. Is history creating transition states and failing states at once? Is it just madness or is there method to the madness?

One variable is probably less important than it seems: the end of the Cold War and the superpowers' consequent waning of interest in geostrategic stability. Certainly, a number of authoritarian regimes were weakened when the support they had enjoyed was withdrawn. But some rebel movements (such as UNITA in Angola) suffered the same fate. And the rich world only dropped very few regimes altogether. Since September 11, 2001 at the latest, there has been a keen new interest in potent states which have their societies "under control". That interest typically goes along with pressure to make the transition to democracy and market economy. This pressure is not only applied explicitly by rich donors, multilateral institutions and international NGOs. It is also implicit in the example of success, power and wealth they set. Today, democracy and market economy are the only yardstick of development.

The combination does seem unbeatable. All comparative studies (Przeworski et al., 2000) confirm its success internationally. A virtuous circle ensures that affluence stabilises democracy in the short term and promotes it in the long term. In turn, democracies lead to prosperity and an equitable distribution of wealth (Siegle et al., 2004). Legitimacy also seems guaranteed. After all, market transactions are always fair because they are voluntary. Then again, initial distribution patterns (particularly those of wealth) are normally not taken into account. But, as power resides with the majority in a democracy, "unfair" market results can be corrected. After all, democratic procedures – especially elections – define what is legitimate. So what is stopping the triumphal march of this dream couple?

Transition and redistribution

In spite of fulfilling formal criteria, most of the new democracies are "defective" (Merkel, 2004). And yet they are fairly stable (Carothers, 2002). At the same time, there is a large number of authoritarian regimes and a whole string of failed states. In most cases, these failed states have no clear regime. Rivalling warlords and other decentralised groups are in control of various regions and business sectors. In other cases, the international community has set up a protectorate to stop matters from deteriorating.

A first explanation for the resilience of undemocratic structures lies in the phenomenon which the high priests of the free market tend to overlook: the unequal distribution of wealth and, consequently, incomes. As long as long-privileged elites fear expropriation, real democratisation is unlikely (Boix, 2003). The more immobile their assets (real estate, natural resources) and the more pronounced the inequality, the more elites have to fear for. Where inequality is less evident and assets fairly mobile, however, taxation is likely to be moderate (as, otherwise, assets would move on). This kind of setting makes democratisation more likely, because rich elites weigh up the costs of democratisation against those of oppression.

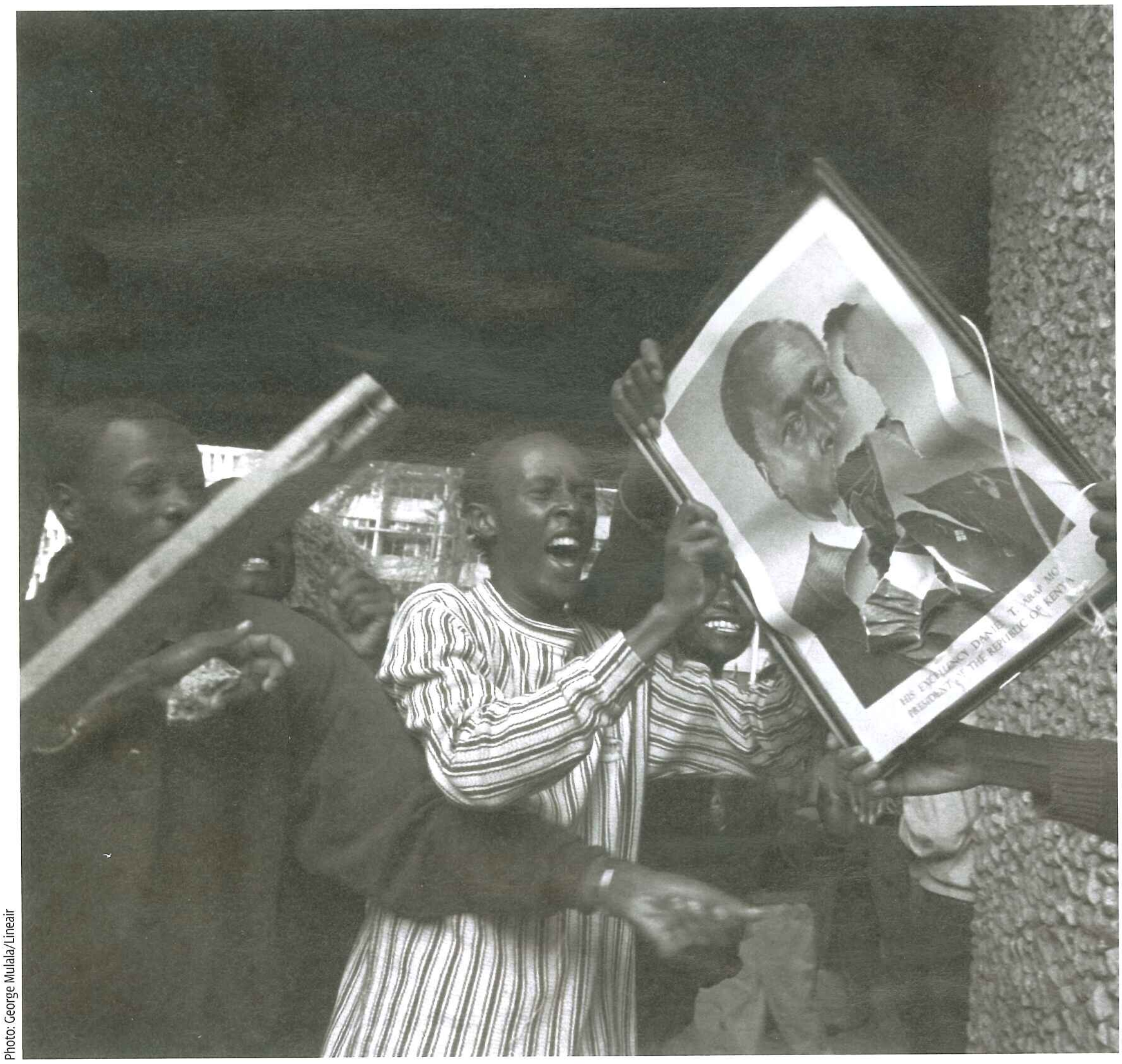


Photo: George Mulala/Lineair

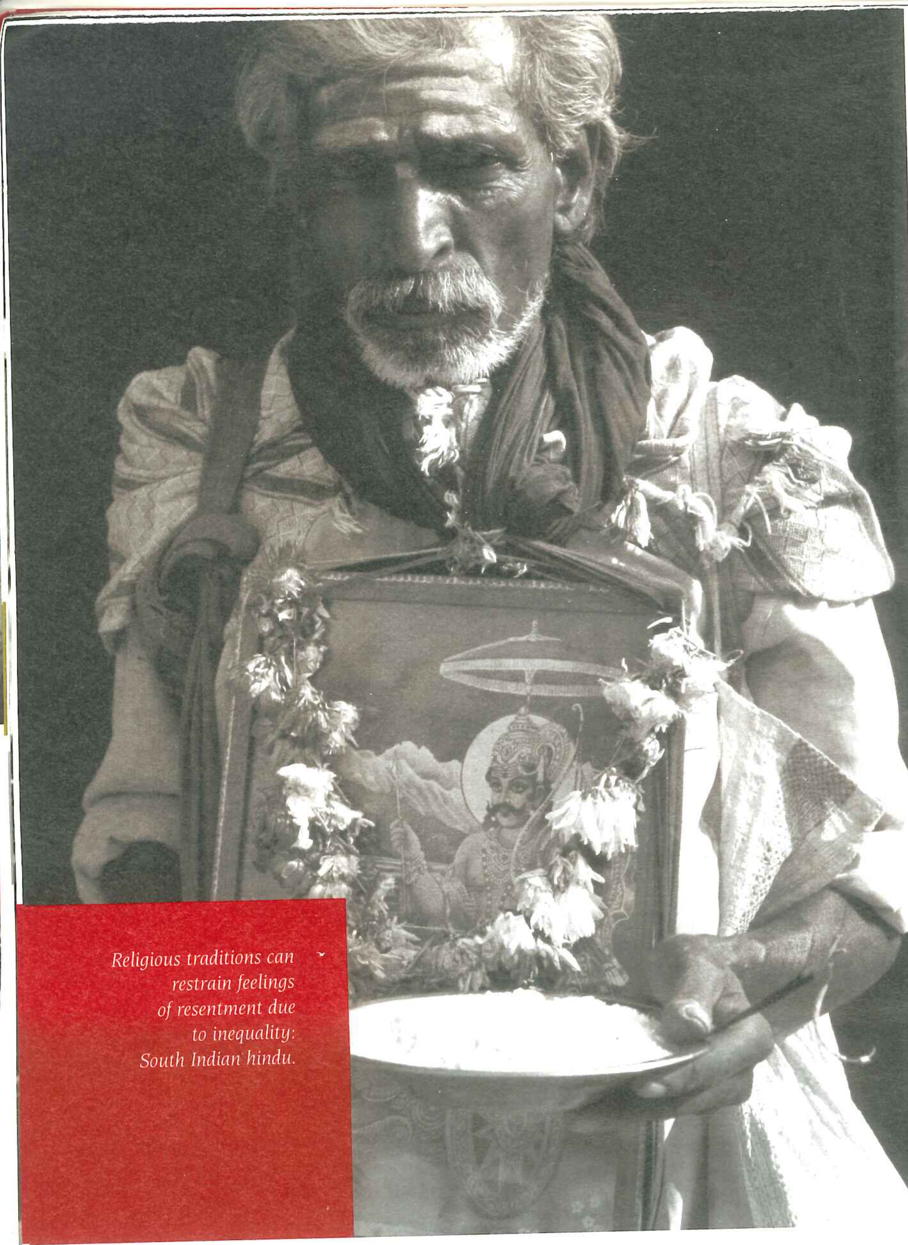
Daniel arap Moi was Kenya's elected president and became unpopular after many years in office.

Today, the classic dictatorship, in which a small oligarchic elite exploits and oppresses a massive class of the poor like Somoza's regime did in Nicaragua, has become a fairly rare phenomenon. In most cases of rent-economies, elites with authoritarian leanings (detailed discussion of the term in Dauderstädt, 2004) co-opt sections of the population in patronage networks. Through these, they distribute some of their rental income – in return for political support and services (for instance, in the security apparatus). Where these mechanisms fail, the threat of terrorism looms (Kitschelt, 2004). Anyone seeking to change such a regime faces not just opposition from the oligarchy but also from its relatively large client groups. Making things more difficult, these groups also hold a monopoly on qualifications needed to govern a country. There is little chance of running a state without them – and even less against their opposition.

Socio-cultural embeddedness

It is fairly obvious and understandable that interest, power and social structures slow down the process of transition. But there are other, even deeper blockades. The "free" market is not as simple a concept as the term suggests. For markets to work, they need a comprehensive legal, institutional, social an even cultural infrastructure. That is why such a colourful array of "capitalisms" has emerged among democratic market economies.

All economic systems have markets. Even under Communism, markets served to supply consumers. However, one way or another, markets are always socially and politically circumscribed. To a large extent, the growth that makes up the (apparent?) prosperity of rich nations today stems from the transformation of non-market interaction into trading relations: from subsistence/self-sufficient farming to an economy where the three percent of the population engaged in agriculture produces the food for all the rest; from the cashless to the capitalised household (food conservation, washing, cooking, cleaning, child-rearing). However, there are evidently cultural limits to marketisation, boundaries beyond which massive resistance can be expected even at the expense of economic growth. After all, not everything is deemed a marketable commodity. Where are the cultural limits for selling drugs, for example, or arms, human organs and sexual services?



Religious traditions can restrain feelings of resentment due to inequality: South Indian hindu.

complete or perfectly balanced. Risks are particularly great in asset markets, where claims and liabilities extend over long periods of time. Capital markets, if poorly regulated and supervised, can turn a transition country into a failed society. That happened in Albania in 1994, when fraudulent pyramid investment schemes that offered crazy yields first escalated and then collapsed. Richer societies are more resilient, although, even in their case, stock market bubbles can cost large sections of the population their savings. Nowadays, however, that does not cause societal chaos; the worst that seems to happen, so far, is an upsurge of populism.

Reducing risks entails costs, especially information costs. These are higher in societies without a common language. The number and volume of market transactions would decrease dramatically, if one had to bear the full burden of information costs in every single case. Markets can only operate because market players expect risks to remain within limits. Those expectations are based on trust in personal networks, social norms or effective regulators (Fukuyama, 1995). The less norms, morality or culture support such trust, the more formal (normally government-appointed) agencies are needed to monitor markts, punish wrong doing and inspire confidence. The costs of such agencies add to the tax burden and place additional strain on societal resources. That is probably one of the reasons why heterogeneous societies (for instance in an ethnic-linguistic sense) normally perform less well in terms of economy and governance (Alesina, 2004).

Where governance and morals fail, trust is confined to personal networks, limiting transactions and thus prosperity. Such personal networks even and especially exist in failed states. Wherever formal systems are marked by shortcomings, personal contacts become relevant. That is something which needs to be remembered by those running peace-building missions, who tend to assume they are working with a societal tabula rasa (Pouligny, 2004). Networks ("civil society") helped overcome supply bottlenecks in the centrally planned economies of the Communist states. Even in capitalist welfare states, the shadow economy is relentlessly growing. Where social norms and positive law start to fall apart, the borderline between mutual self-help and mafia-like structures becomes blurred. The status of private networks/civil society is defined by what the state sanctions or holds to be wrong.

Another matter that is only tolerated up to a point is the privatisation of what used to be collectively owned property. During the transformation of the state-managed Communist economies, privatisation was a source of considerable conflict. This was particularly so whenever property was sold to foreigners, who were not trusted to make "socially responsible" use of their acquisitions. And indeed, companies were often bought and then closed down to eliminate unwanted competition. Even in mature market economies, such moves attract censure. Recent corporate takeovers – for instance Vodafone's hostile bid for control of Mannesmann – provide the evidence. Naomi Klein (2005) reckons a considerable amount of the violent resistance seen in Iraq is linked to fears triggered by the extremely liberal market economy decreed by the occupier and the inherent privatisation risks.

Risks, confidence and social networks

All market transactions involve risks – and the distribution of risks is unequal because information is never

The less society accepts the existence and consequences of legally defined market rules, the greater the threat of instability becomes. Regulations are flaunted and undermined by private action ranging from shoplifting to bank robbery, from smuggling to drug trafficking, from moonlighting to social security fraud.

Personal satisfaction depends on more than just levels of income. It also hinges on the sense of security afforded by social networks built on trust and accepted social norms. Even in advanced nations, this serves as the base of the formal relationship between the law and the market. Where it diminishes, transaction costs and risks escalate – and people's sense of social justice decreases as a result.

Happiness does not simply grow in line with average prosperity; it depends to a very great degree on relative distribution (Layard, 2004). Where some get rich quick while others see their incomes stagnate or – in relative terms at least – decrease, dissatisfaction increases. If networks guarantee access to prosperity and to a secure, "decent" standard of living, the sense of identity established by belonging to those networks becomes vital and politically virulent. Ethnic and religious identities are instrumentalised for distributive interests. Where political conflict lines are drawn along such fronts, great efforts are required to keep the conflicts non-violent. Mounting populism and ethnic conflict – not just in transition states – are also a response to changing patterns of opportunities in life due to opaque and seemingly immutable global market processes. However, as the example of India's caste system shows, unfair conditions can also be legitimised and stabilised by culture and religion. That is why inequality does not automatically produce conflict (Cramer, 2001).

Globalisation is broadening horizons and opening eyes to fabulous promises of prosperity – with new attendant risks. Distribution of wealth within societies is increasingly influenced by external actors. For transition's losers, disappointment and anger are almost naturally channelled along ethno-cultural lines. The break away from traditional stability can lead not only to modernisation but also to the chaos of new conflicts. Anyone who wishes to avoid those conflicts is well advised to respect the cultural norms and social networks on which the cohesion and stability of a transition society depend. Successful transition is only found where modern structures are embedded in societal identity.

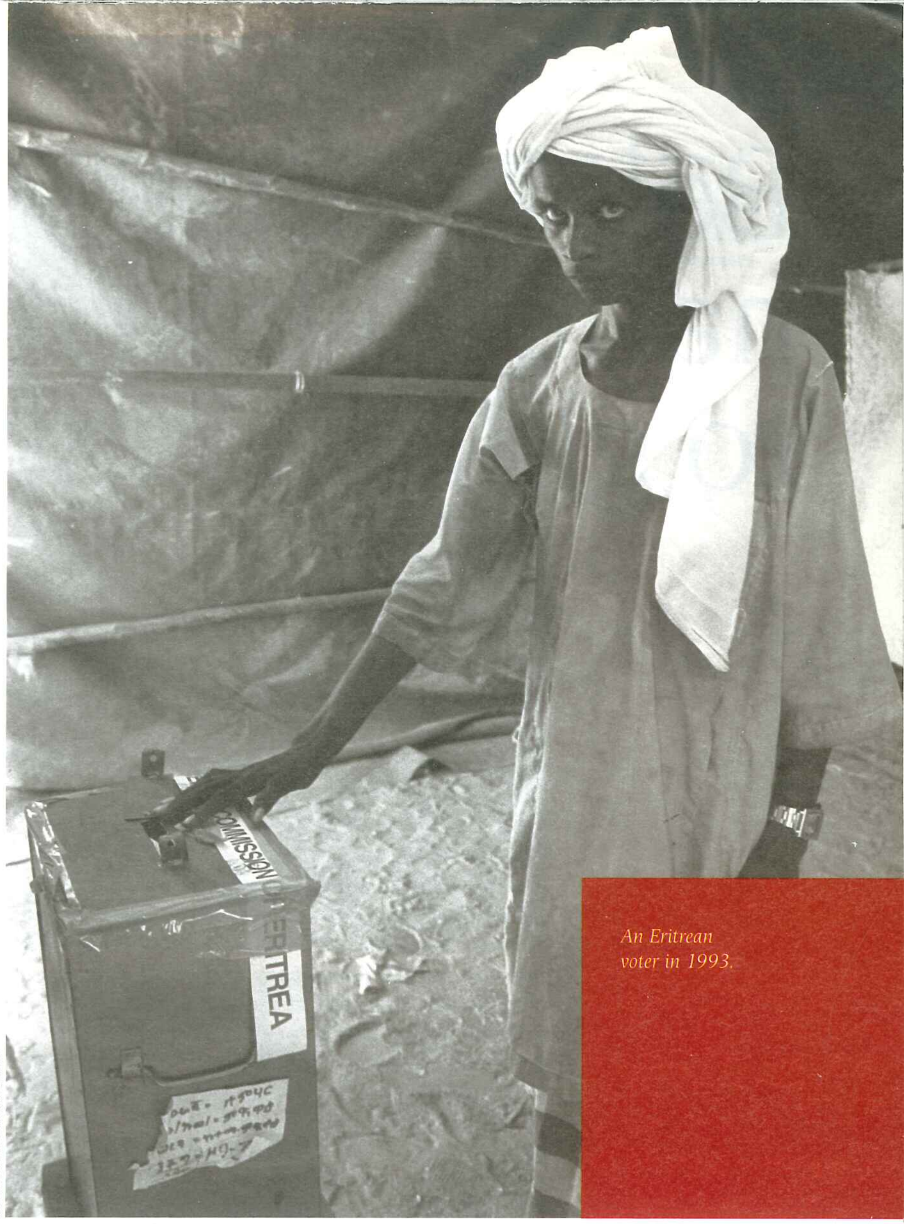


Photo: Donald Bostrom/Lineair

An Eritrean voter in 1993.

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