

## **Globalization and Governance**

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I should start by admitting at the outset that I have but little knowledge of the Portuguese situation and cannot comment in any useful way on issues peculiar to Portugal. I hope, however, that I might make some helpful, or at least provocative, contributions to the discussion of governance issues and globalization.<sup>1</sup>

To make matters simple, I will offer three theses. Before offering my modest theses, however, it may help to stipulate some definitions of governance and of globalization.

The term governance has only recently entered into discussions of institutions and policies, both in the context of states and private bodies (hence, “corporate governance”). Most political science discussions have until recently focused primarily on political democracy, with the emphasis on elections for holders of power, with little attention paid to the other institutions of a well functioning political and legal system, such as the judiciary and systems of checks and balances. Recently more attention has been turned to, not merely how power is gained, but how it is limited, how it is administered, and how it is used. Thus, governance is a catch-all term for the processes of governing (e.g., federalism, the role of the judiciary, presidential vs. parliamentary systems, etc.), for the effective administration of policies (e.g., relative presence or lack of corruption, effectiveness of implementation), and for quality of the policies themselves, as measured against various generally desirable policy outcomes (e.g., increasing general prosperity,

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<sup>1</sup> I took part recently in a working session of a conference of the New School of Athens on “Democracy, Development, Good Governance: Competing or Complementary Goals?” and some of my remarks are stimulated by what I learned from the papers presented and the discussions there. <http://www.cityofathens.gr/portal/site/AthensPortalEN/menuitem.281960df388bc156a25368212d4a76e3/?vgnnextoid=d05f54a0b2529010VgnVCM100000d2a4673eRCRD>

longevity, public health, security of life, liberty, and property, etc.). I will use the term governance to refer to the mechanisms that sustain the rule of law (in contrast to arbitrary power, whether autocratic or majoritarian), political and legal stability, and policies conducive to generally desirable outcomes, such as rising standards of living, lower unemployment, and so on.<sup>2</sup>

Now to globalization. It's common for self-styled opponents of globalization to use the term as a catchall for all the features of human life that they consider undesirable, including inequality, loss of cultural "authenticity," and infectious diseases. I prefer to use the term globalization in an operationalized, rather than moralized, way to refer more precisely to the diminution or elimination of state-enforced restrictions on exchanges across borders and the increasingly integrated and complex global system of production and exchange that has emerged as a result. The core policy issue is whether a border should be used to stop transactions that would be allowed if both parties were on the same side of it. Should American wheat farmers be allowed to buy cell phones from people in Finland? Should Ghanian weavers be allowed to sell the shirts and pants they make to German autoworkers? Should Taiwanese investors be allowed to buy securities

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<sup>2</sup> Daniel Kauffman offers a lengthier definition in "Rethinking Governance: Empirical Lessons Challenge Orthodoxy" ([www.worldbank.org/wbi/governance/pdf/rethink\\_gov\\_stanford.pdf](http://www.worldbank.org/wbi/governance/pdf/rethink_gov_stanford.pdf)): "*Governance* is defined as the exercise of authority through formal and informal traditions and institutions for the common good, thus encompassing: (1) the process of selecting, monitoring, and replacing governments; (2) the capacity to formulate and implement sound policies and deliver public services, and (3) the respect of citizens and the state for the institutions that govern economic and social interactions among them. For measurement and analysis, the three dimensions in this definition of governance can be further unbundled to comprise two measurable concepts per each of the dimensions above, for a total of six components: (1) *voice and external accountability* (i.e., the government's preparedness to be externally accountable through citizen feedback and democratic institutions, and a competitive press); and also (2) *political stability and lack of violence, crime, and terrorism*. Then (3) *government effectiveness* (including quality of policymaking, bureaucracy, and public service delivery); (4) *lack of regulatory burden*; and, finally, (5) *rule of law* (protection of property rights, judiciary independence, and so on); and (6) *control of corruption*. *Governance* is thus a much broader notion than *corruption*, the latter being *one* (albeit admittedly very important) among a number of closely intertwined governance components."

or other assets from Canadian shareholders?

The pressing questions are what the effects of globalization actually are and whether they're beneficial or harmful. In our case, we are primarily concerned with the relationship between globalization and governance.

*1. There is strong evidence that globalization tends to spread practices of good governance.*

Countries with a greater degree of globalization tend to have better governance overall than those that are less globalized. *Foreign Policy* magazine, in conjunction with A. T. Kearny, Inc., produces an annual globalization index. The most recent index involved 62 countries (accounting for 96 percent of the world's GDP and 85 percent of the world's population) and measured 12 variables spread across four areas: "economic integration, technological connectivity, personal contact, and political engagement."<sup>3</sup> They compared that index with other measurable variables, including vulnerability to terrorist attack and political rights and civil liberties. With regard to the former, they found no significant correlation. With regard to the latter, they found that "There is a strong positive relationship between globalization and political freedom. Globalization may also be one of the best ways of keeping politicians honest, as more globalized

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<sup>3</sup> "Measuring Globalization," *Foreign Policy*, May/June 2005: 52-60. One might dispute some of the elements of the index, but it should serve our purposes well. For example, the elements of political engagement – country membership in international organizations, personnel and financial contributions to U.N. peacekeeping missions, international treaties ratified, and governmental transfers – are not necessary elements of globalization as I have defined it; nonetheless, such factors tend to track the others, so there's little difference from a globalization index using the definition I offered.

countries have far lower levels of perceived corruption, as measured by Transparency International.”<sup>4</sup>

Building on that research, economists from the Federal Reserve Bank of Dallas compared the *Foreign Policy* index of globalization with various indicators of good governance and found very robust positive correlations between the degree of globalization and good governance.<sup>5</sup> Some of the elements that they identify as good governance might be disputed by people who are generally hostile to markets, such as flexibility of labor market regulations and the degree of protection for property rights, but a few should be quite uncontroversial. For example, one of the most effective ways to rob a population and at the same time deeply disrupt the social and political order is to inflate the currency. I doubt that many people, even those who are deeply hostile to free markets, who would champion high rates of inflation *per se*. What we find is that as globalization has increased over the last twenty years, rampant inflation has been tamped down, falling from an average of 10.3 percent among the largest developed nations between 1973 and 1983 to an average of 1.8 percent annually since 1995. As Cox and Alm note, “[P]rice stability goes hand in hand with globalization. Nations in the bottom quarter had average inflation of 10 percent for 2001 to 2003. Rates tend to fall as nations globalize, reaching an average of 2.3 percent for the top quarter.”<sup>6</sup>

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<sup>4</sup> “Measuring Globalization,” *Foreign Policy*, May/June 2005, p. 59.

<sup>5</sup> “Racing to the Top: How Global Competition Disciplines Public Policy,” by W. Michael Cox and Richard Alm, 2005 Annual Report, Federal Reserve Bank of Dallas, and “Globalizing Good Government,” by Richard W. Fisher and W. Michael Cox, *New York Times*, April 10, 2006, A25. The Federal Reserve Bank study excluded 2 of the countries in the Foreign Policy index, Botswana and Croatia, because of a lack of complete data comparability.

<sup>6</sup> “Racing to the Top: How Global Competition Disciplines Public Policy,” by W. Michael Cox and Richard Alm, 2005 Annual Report, Federal Reserve Bank of Dallas, p. 7. The relationship between globalization and monetary policy is examined in “Globalization and Monetary Policy,” by Mark Wynne,

Political stability (such as regular elections and peaceful transitions of power), accountability, rule of law, government effectiveness, lack of corruption, and other features all correlate positively with the degree of globalization and tend to increase over time with the increase of globalization.

The Fraser Institute of Canada produces a study of the status of economic freedom in 128 different countries.<sup>7</sup> A major element in the generation of the metric of economic freedom in that study is the degree of freedom of trade afforded to citizens. It is not surprising that openness to trade tends to go hand-in-hand with other forms of economic freedom; what is interesting for our purposes is the remarkable inverse correlation between economic freedom and corruption, as shown in this graph from the 2005 report:

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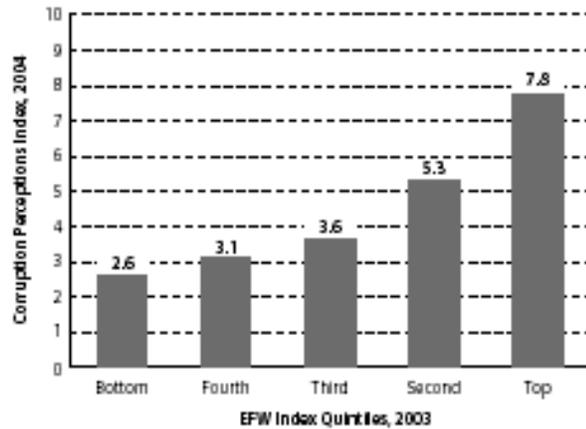
*Southwest Economy*, Issue 4, July/August 2005, Federal Reserve Bank of Dallas. As Wynne notes, the gold standard provided a significant brake on inflation, as did – albeit less strictly – the Bretton Woods system of fixed exchange rates. Following the collapse of that system in 1971, inflation surged, until the early 1990s, when central bank restraint reigned in inflation. As Wynne notes, “[S]ince then, the number of countries experiencing high inflation has declined to nearly zero. The average inflation rate has also declined, from a peak of more than 35 percent in the early 1990s to less than 5 percent today.” Easing or abolition of restrictions on financial flows has created strong incentives for monetary authorities to exercise restraint.

<sup>7</sup> *Economic Freedom of the World*, by James Gwartney and Robert Lawson with Erik Gartzke (Vancouver: Fraser Institute, 2005). The report is published in the U.S. by the Cato Institute and in Portugal by *Causa Liberal*.

*With fewer regulations, taxes, and tariffs, economic freedom reduces the opportunities for corruption on the part of public officials.*

Note: Corruption is measured on a scale from zero to 10: 10 = little or no corruption; zero = highly corrupt.

Sources: The Fraser Institute; Transparency International, *Corruption Perceptions Index 2004* ([http://www.transparency.org/cpi/2004/cpi2004\\_en.html#pci2004](http://www.transparency.org/cpi/2004/cpi2004_en.html#pci2004), as of July 5, 2005).

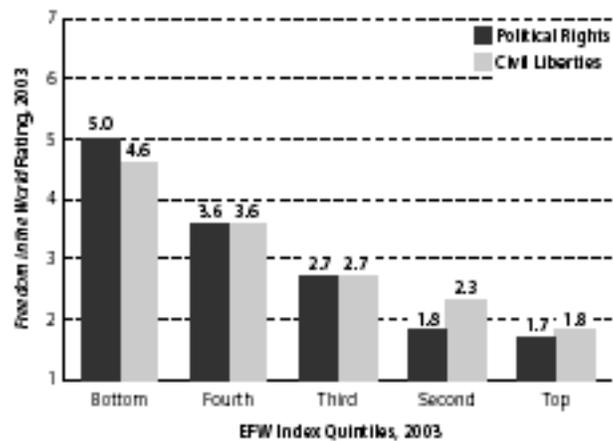


Moreover, economic freedom is correlated with political rights and civil liberties:

*Political rights (e.g., free and fair elections) and civil liberties (e.g., freedom of speech) go hand in hand with economic freedom.*

Note: Political rights and civil liberties are measured on a scale from one to seven: one = the highest degree of political rights/civil liberties; seven = the lowest.

Sources: The Fraser Institute; Freedom House, *Freedom in the World Country Ratings, 1972 through 2003* (<http://www.freedomhouse.org/ratings/index.htm>, as of July 5, 2005).

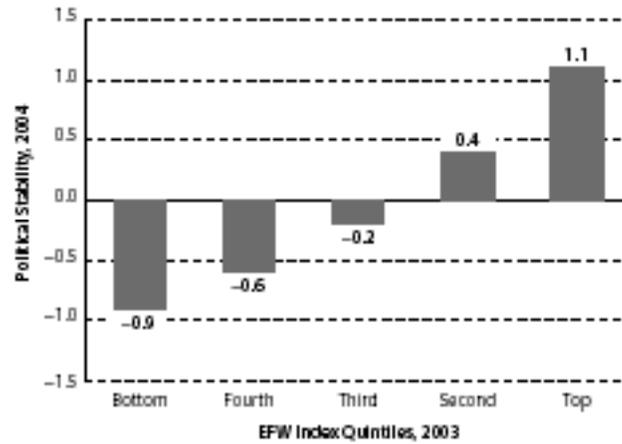


with political stability:

Political stability increases with economic freedom.

Note: The ratings for political stability range from about -2.5 to 2.5, with higher values corresponding to higher political stability.

Sources: The Fraser Institute; The World Bank Group, *Governance & Anti-Corruption* (<http://info.worldbank.org/governance/klz2004/tables.asp>, as of July 5, 2005).

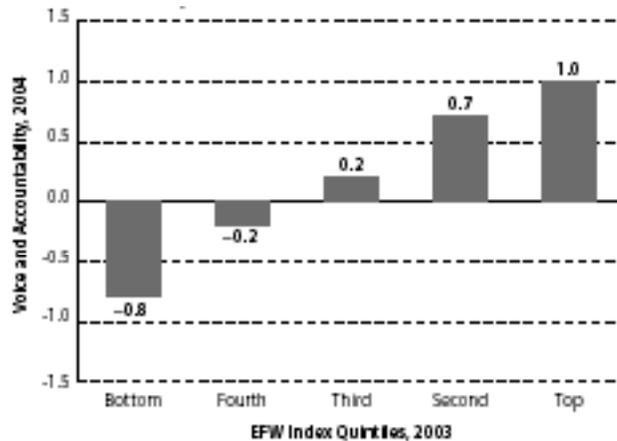


and with voice and political accountability:

Voice and accountability increases with economic freedom.

Note: Voice and Accountability measures the extent to which citizens of a country are able to participate in the selection of governments and ranges from about -2.5 to 2.5, with higher values corresponding to higher voice and accountability.

Sources: The Fraser Institute; The World Bank Group, *Governance & Anti-Corruption* (<http://info.worldbank.org/governance/klz2004/tables.asp>, as of July 5, 2005).



What of environmental policy? Environmental amenities are substantially a function of income. The “Environmental Kuznets Curve” indicates an inverted-U shaped curve, with environmental degradation going up as income increases, and then declining.<sup>8</sup> That is a bit misleading, since many forms of pollution are in fact declining rapidly in the early stages of rising income: cholera, typhus, malaria, and so on. The Environmental Kuznets Curve misses those forms of pollution because the wealthy people who devise

<sup>8</sup> “The Simple Analytics of the Environmental Kuznets Curve,” James Andreoni and Arik Levinson, National Bureau of Economic Research, Working Paper 6739, September 1998: <http://www.nber.org/papers/w6739>

them simply don't see them as pollution any more; the focus of people in wealthy countries has shifted to man-made forms of pollution. As people become richer (and as certain types of pollution, such as malaria, are reduced), they create more pollution up to some level of income, when they begin to use the next increments of income to purchase environmental amenities, i.e., falls in pollution levels. (There is a great deal of controversy about the exact level of income at which the direction of the curve changes.) It is no accident that wealthier countries tend to have lower levels of pollution, for two reasons. First, wealth creation tends to be correlated with respect for property generally, and pollution is best seen as a form of property rights violation which is restrained by well-defined and legally secure property rights. Second, people tend to purchase more environmental amenities, such as cleaner air and water, nature preserves, and so forth, as their incomes rise.

What about environmental standards? Many opponents of globalization claim that there is a 'race to the bottom' in environmental standards. But the evidence indicates the opposite, that involvement in international treaty organizations such as the World Trade Organization has led to the spread of more – not less – stringent restrictions on pollution and contaminants and greater – not less – protection of endangered species.<sup>9</sup> WTO negotiations resulted in the adoption of U.S. dolphin-free tuna standards in countries that trade with the U.S. and of turtle-exclusion devices (which allow endangered sea turtles to escape shrimp nets) in shrimp producing nations that export to the U.S.

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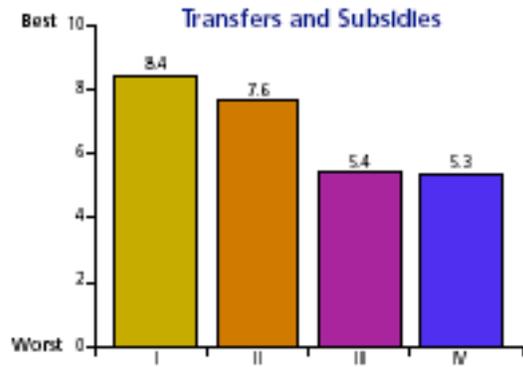
<sup>9</sup> See the treatment of environmental and public health cases in *Free Trade Under Fire*, by Douglas A. Irwin (Princeton: Princeton University Press, 2002), pp. 191-209.

For those who prefer, all other things being equal, lower taxes to higher taxes, it is noteworthy that increasing globalization has created incentives for reducing various levels of taxation (corporate income tax levels are falling rapidly in the European Union, for example. Rates of taxation on personal income dropped significantly around the world between 1980 and 2000, with South Korea dropping rates by 45 percentage points, Portugal by 44 points, and Britain by 43 points. Corporate income tax rates also fell, with Ireland and Sweden leading the pack, with rates falling by 26 points and by 24 points, respectively.<sup>10</sup>

Remarkably, and somewhat regrettably from this writer's perspective, at the same time that corporate and personal income tax rates have fallen in response to globalization, the most globalized countries tend to have the highest levels of transfers and subsidies. Evidently, being richer (and increased globalization is definitely correlated with higher GDP per capita) means that taxpayers can afford higher expenditures on subsidies.

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<sup>10</sup> "Racing to the Top: How Global Competition Disciplines Public Policy," by W. Michael Cox and Richard Alm, 2005 Annual Report, Federal Reserve Bank of Dallas,, p. 9. It's worth noting that the shift tends to be from more mobile factors of production to less mobile factors, so that land and labor, which are the factor of production most restricted in mobility, the one due to the natural immobility of land and the other due to a combination of political restrictions on mobility and social, linguistic, and other reasons people have for remaining in the country of their birth.



Source: Federal Reserve Bank of Dallas

Note: A higher score on the vertical axis refers to greater control of public expenditures on transfers and subsidies and a higher score on the horizontal axis refers to greater degree of globalization.

There is also evidence that the greater diversity of populations characteristic of highly globalized economies is also correlated with economic growth and investment in high-tech (and, incidentally, less polluting) industries. The presence of high percentages of foreign-born inhabitants of American cities, for example, is correlated with growth of high-income and high-tech industries, as is the percentage of urban populations that is homosexual.<sup>11</sup>

The evidence is not merely consistent with the thesis that globalization is correlated with generally positive trends in governance, but also strongly suggestive that increasing globalization creates incentives for better governance. The ability of people to move themselves and their assets in search of better conditions tends to create incentives

<sup>11</sup> Richard Florida and Gary Gates, "Technology and Tolerance: The Importance of Diversity to High-Technology Growth," Brookings Institution Center on Urban & Metropolitan Policy (June 2001): <http://www.brook.edu/es/urban/techtol.pdf>

for providers of governance to provide better quality governance than would otherwise be the case.<sup>12</sup>

*2. Good governance depends on good incentives, since incentives shape behavior, and good incentives depend on good institutions, since institutions give form to incentives, both for the governors and for the governed. Specifically, institutions that create stable legal frameworks for peaceful cooperation create incentives for social and economic development. Such institutions receive positive support from the process of globalization.*

After so many examples of “well intentioned” but disastrous attempts to recreate or improve societies, the attention of serious thinkers has shifted decidedly from intentions to consequences. A scientific approach to policy that is oriented to consequences, rather than to intentions, requires attention to incentives, which shape behavior and therefore consequences. A focus on incentives leads to the study of institutions. As Douglass North notes, “Institutions provide the incentive structure of an economy; as that structure evolves, it shapes the direction of economic change towards growth, stagnation, or decline.”<sup>13</sup> Institutions include – but are not limited to – organizations: “Institutions are a set of rules, compliance procedures, and moral and

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<sup>12</sup> Some might wonder whether, in focusing on the effect of globalization on domestic governance, I have ignored pressing issues of “global governance” occasioned by globalization. I do not believe that the process of globalization, when driven by freedom of trade and travel, requires an additional level of global governance. Organizations such as the World Trade Organization do not “govern trade,” they simply provide a treaty mechanism for states gradually to liberalize (one hopes) their trade regimes. Those issues governing externalities such as communicable diseases are addressed more, not less, effectively precisely because of the freer flows of information and capital. See Jagdish Bhagwati, *In Defense of Globalization* (Oxford: Oxford University Press, 2004), pp. 221-27.

<sup>13</sup> Douglass C. North, “Institutions,” *Journal of Economic Perspectives*, Vol. 5, No. 1 (Winter 1991), p. 97.

ethical behavioral norms designed to constrain the behavior of individuals in the interests of maximizing the wealth or utility of principals.”<sup>14</sup>

When we approach the creation of formal institutions, or organizations, to provide governance, the problem is to create institutions with sufficient powers to administer justice and secure public order effectively but limited so that they do not themselves act in a purely predatory way and lawless manner.<sup>15</sup> James Madison framed the problem neatly in Federalist Number 51: “In framing a government, which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed, and in the next place, oblige it to control itself.”<sup>16</sup>

Constitutional liberal democracy seems, thus far, the best mechanism for achieving such balances. By that, I mean something more than simply choosing governors at the ballot box: a stable constitutional framework of the rule of law, given force by the division of powers and checks, whether formal or informal, on holders of power. Not only is such a system a necessary condition for economic prosperity and social development, but it is presupposed for democratic systems to be stable, in any case. As Mancur Olson noted,

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<sup>14</sup> Douglass C. North, *Structure and Change in Economic History* (New York: W. W. Norton & Co., 1981), pp. 201-2. See also World Bank, *Building Institutions: World Development Report 2002* (New York: Oxford University Press, 2002), esp. chap 1, “Building Institutions: Complement, Innovate, Connect, and Compete.”

<sup>15</sup> More precisely, the problem is to create conditions such that the amount of predation attributable to government is at least less than that prevented by government.

<sup>16</sup> James Madison, Federalist No. 51.

“Interestingly, the conditions that are needed to have the individual rights needed for maximum economic development are exactly the same conditions that are needed to have a *lasting* democracy. Obviously, a democracy is not viable if individuals, including the leading rivals of the administration in power, lack the rights to free speech and to security for their property and contracts or if the rule of law is not followed even when it calls for the current administration to leave office. Thus the *same* court system, independent judiciary, and respect for law and individual rights that are needed for a lasting democracy are also required for security of property and contract rights.”<sup>17</sup>

So the question is, does globalization tend to increase the trend toward democracy? There is strong evidence from the historical emergence of parliamentary control over European autocrats that globalization played a central role. As North and Weingast argue, constitutionalism created a system whereby the commitments of governors were made credible. “What established the government’s commitment to honoring its agreements – notably the promise not to appropriate wealth or repudiate debt – was that the wealth holders gained a say in each of these decisions through their representatives in parliament. This meant that only if such changes were in their own interests would they be made. Increasing the number of veto players implied that a larger set of constituencies could protect themselves against political assault, thus markedly reducing the circumstances under which opportunistic behavior by the government could

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<sup>17</sup> Mancur Olson, “Dictatorship, Democracy, and Development,” *American Political Science Review*, Vol. 8, No. 3 (September 1993), 567-76, 572.

take place. In the story we have told, the emergence of political and civil liberties was inextricably linked with economic freedom.”<sup>18</sup>

But how did the wealth holders acquire their wealth? As Acemoglu, Johnson, and Robinson argue, the institutional changes that fostered economic growth occurred in those countries where trade was not monopolized and limited by the sovereign. Spain and Portugal, for example, also had direct access to Atlantic trade, but, in contrast to England and the Netherlands, trade was typically monopolized by the crown. After examining the evidence, they conclude that “Overall, both the British and Dutch evidence appears favorable to our hypothesis that Atlantic trade enriched a group of merchants who then played a critical role in the emergence of new political institutions constraining the power of the crown.”<sup>19</sup>

The same process goes on in globalized nations today. Independent merchants, traders, manufacturers, banks, importers and exporters, and other groups have sufficient power to restrain the state and to assert some interest in the security of property, imperfectly, to be sure, but with much more efficacy than in less globalized nations. It is in that manner that the basic problem of time-inconsistency is at least partly solved, namely, the problem that a ruler can express a preference and make a promise at time A,

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<sup>18</sup> Douglass C. North and Barry R. Weingast, “Constitutions and Commitment: the Evolution of Institutions Governing Public Choice in Seventeenth-Century England,” in Alston, Eggertsson, and North (eds.), *Empirical Studies in Institutional Change* (Cambridge: Cambridge University Press, 1996), 134-65, 162.

<sup>19</sup> Daron Acemoglu, Simon Johnson, and James Robinson, “The Rise of Europe: Atlantic Trade, Institutional Change and Economic Growth,” *American Economic Review*, v. 95 (June 2005) 546-579, [http://econ-www.mit.edu/faculty/download\\_pdf.php?id=1181](http://econ-www.mit.edu/faculty/download_pdf.php?id=1181), p. 23. They quote Rondo Cameron (A Concise Economic History of the World [New York: Oxford University Press, 1993], p. 127) as follows: “The spice trade in the East Indies of the Portuguese Empire was a crown monopoly; the Portuguese navy doubled as a merchant fleet, and all spices had to be sold through the *Casa da India* (India House) in Lisbon ... no commerce existed between Portugal and the East except that organized by the state.”

but find that at later time B his preference is not to honor it. How can he credibly commit at time A, in such a way that he will have an incentive at time B to honor that commitment? A pure autocrat, an unlimited sovereign, has no such incentive. As Mancur Olson explains, “the promise of an autocrat is not enforceable by an independent judiciary or any other independent source of power—by definition autocrats can overrule all other power sources. Due to this situation and the obvious possibility that a dictator could come to could come to take a short-term view, the promises of an autocrat are never completely credible.”<sup>20</sup>

A robust civil society—historically, a society in which production and exchange characterizes economic relations<sup>21</sup>-- that can restrain the governors depends on the availability of trading options that are not monopolized by the state. Good institutions are those that can clearly define property, provide legal security for property (understood in Locke’s terms as “life, liberty, and estate”<sup>22</sup>), and facilitate voluntary transfers of property. (That is, property must be definable, defendable, and divestible.) One consequence of such a policy is investment, from both domestic and foreign sources.

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<sup>20</sup> Mancur Olson, *Power and Prosperity* (New York: Basic Books, 2000), p. 27.

<sup>21</sup> Anthony Black describes the values of civil society as, “[F]irst, personal security in the sense of freedom from the arbitrary passions of others, and freedom from domination in general. This involves freedom (or security) of the person from violence, and of private property from arbitrary seizure. But these, it would appear, can only be maintained if legal process is credibly and successfully enforced as an alternative to physical force, in settlement of disagreements, and in redressing wrongs committed by violence. This leads to the notion of legal rights (whether or not so called), both in the sense of the right to sue in court on equal terms with everyone else--legal equality--and in the sense of claims, for example to property, recognized and upheld by law.” *Guilds and Civil Society, in European Political Thought from the Twelfth Century to the Present* (Ithaca, N.Y.: Cornell University Press), p. 32. Compare Reinhard Bendix, *Kings or People: Power and the Mandate to Rule* (Berkeley: University of California Press, 1978), p. 523: “civil society refers to all institutions in which individuals can pursue common interests without detailed direction or interference from the government.”

<sup>22</sup> “[A] Power, not only to preserve his Property, that is, his Life, Liberty and Estate....” John Locke, *Two Treatises of Government, Second Treatise*, Chap. VII, §86 (Cambridge: Cambridge University Press, 1988), p. 323.

And contrary to the fallacious reasoning of so many, investment is not attracted by “low wages,” but by returns (discounted by the risk, including the risk of confiscation). Unsurprisingly, we find that foreign direct investment goes overwhelmingly, not to low-wage countries, but to high-wage countries.<sup>23</sup> Two reasons can be advanced for that. First, high wage countries are countries that have security of property, so the risk of confiscation is lower. Second, high wages tends to mean low labor costs, not high labor costs. The fundamental confusion of anti-globalization ideologues is that between wages and labor costs. High wages are a function of a high marginal product of labor, which is in turn a factor of the ratio of capital inputs (including training and other forms of “human capital”) to labor inputs. High wage countries tend to be countries with enormous capital stocks (hence the high wages), meaning that wages tend to represent a smaller portion of the total investment, i.e., that labor costs are lower than in countries where production is more labor-intensive. Rich countries tend to have high wages and low labor costs; poor countries tend to have low wages and high labor costs. The same logic applies to working conditions (the countries that attract the most foreign direct investment have the best working conditions, not the worst), environmental standards, and so on.

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<sup>23</sup> For example, US outward foreign direct investment over the past ten years has gone overwhelmingly to high-wage Canada, Western Europe, and Japan (81%), with less going to lower-but-increasing-wage countries such as Brazil, Thailand, Indonesia, etc. (18%), and with almost none going to low wage countries (notably the entire continent of Africa).

3. *Democracy and Governance Should Not Be Seen as Separate or even Complementary Factors, but as Elements of the Same Institutional Arrangement: Constitutional, Liberal Democracy.*

Much of the literature on governance posits governance as a separate factor among several interrelated factors: democracy, governance, and economic development. That is a serious mistake, both 1) in terms of understanding the relationship among elections (democracy) and the institutions necessary for elections to be held and 2) in terms of promotion of both democracy and good governance.

- 1) Elections that can generate democratic legitimacy require institutions around them to certify their legitimacy. Thus, as Barry Weingast points out, “Because democratic survival requires that political officials observe limits on their behavior—for example, abiding by election results, rules governing policy choice, and a set of political rights of citizens—democracy is a form of limited government.”<sup>24</sup> In Weingast’s model, constitutions provide explicit rules that “trigger” coordinated responses by citizens and other branches of government to transgressions by governors of the rule of law, thus providing mechanisms whereby, as Madison put it, one can “oblige it [the government] to control itself.”
  
- 2) The distinction between democracy and governance suggests that democracy is merely about expressing “the will of the voters” and not about securing

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<sup>24</sup> Barry Weingast, “The Political Foundations of Democracy and the Rule of Law,” *American Political Science Review*, Vol. 91, Number 2 (June 1997), 245-63, 245.

freedom. Minorities, under such a conception, have no protection against majorities. And with the logic of constituencies and rent-seeking at work, such a system entails creation of coalitions of fifty percent plus one to loot the losing population of fifty percent minus one. Such a conception pits groups against groups in a war of redistribution. Within each core group there is possibility of a realignment generate another coalition of looting. In contrast, various constitutionally protected rights and “super majority rules,” which diverge from a simple-minded electoral majoritarianism, tend to create “superencompassing” interests such that resources are devoted to production, rather than to looting. As Olson argues, “Checks and balances and explicit more-than-majority requirements for certain crucial decisions are common in democratic political systems, so bare majorities often cannot get their way, which make superencompassing interests show up more often in many democracies.”<sup>25</sup>

In contrast, when democracy is understood as encompassing good governance, the freedom that is normally associated with democracy is reunited with the principle of majority elections. In that conception, freedom is not merely a matter of expressing will, but of living under the law, i.e., under good governance. As John Locke put it, “*the end of Law* is not to abolish or restrain, but *to preserve and enlarge Freedom*: For in all the states of created beings capable of Laws, *where there is no Law, there is no Freedom*. For *Liberty* is to be free from restraint and violence from others which cannot be, where there is no Law: But Freedom is not, as we are told, *A Liberty for every Man to do what he lists*: (For who could be free, when every other Man’s Humour might domineer over

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<sup>25</sup> Mancur Olson, *Power and Prosperity* (New York: Basic Books, 2000), p. 23.

him?) But a *Liberty* to dispose, and order, as he lists, his Person, Actions, Possessions, and his whole Property, within the Allowance of those Laws under which he is; and therein not to be subject to the arbitrary Will of another, but freely follow his own.”<sup>26</sup>

Limitations on power are best seen as definitive of democracy, not as additional elements that are added on. Weingast put it clearly: “democracy is a form of limited government.” And one of the most important of those limitations is limiting the power of the state to interfere with voluntary trade and travel across national borders.

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<sup>26</sup> John Locke, *Two Treatises of Government, Second Treatise*, Chap. VI, §576 (Cambridge: Cambridge University Press, 1988), p. 306. When Locke criticizes the statement following “as we are told,” he is criticizing Sir Robert Filmer, an advocate of absolutist, i.e., unlimited, government.