DEMOCRACY AND INCLUSIVE GROWTH

States, markets and enterprise in India, Brazil and South Africa

Executive Summary

[include]

A consortium of think tanks from rising democracies

indiabrazilsouthafrica

This issue has been edited by Ann Bernstein

This is an executive summary of a Round Table report, *DEMOCRACY AND INCLUSIVE GROWTH: States, markets, and enterprise* (March 2012). The full-length publication is available from the Centre for Policy Research www.cprindia.org, the Instituto Fernando Henrique Cardoso www.ifhc.org.br and the Centre for Development and Enterprise www.cde.org.za.

CENTRE FOR POLICY RESEARCH
Premier think tank shaping policy debates since 1973

www.cprindia.org

instituto iFHC FERNANDO HENRIQUE CARDOSO

www.ifhc.org.br

CENTRE FOR DEVELOPMENT AND ENTERPRISE
Informing South African Policy

www.cde.org.za

Introduction

Given China's phenomenal achievements over the past three decades, and its growing global power and influence, debates about growth and development are taking place in a changed environment.

Many political leaders in the developing world as well as many other experts and interests now associate successful development with autocratic or authoritarian political systems. Yet many democracies in the developing world are also making significant progress, and notching up real achievements.

The key challenge – which has huge implications for global development and the future of the global community – is to demonstrate that these societies can effectively address issues of growth, poverty and inequality in a democratic environment. And by so doing, and because they are democracies, generate a better quality of life for the vast majority of their citizens.

This is a primary reason for the establishment of INCLUDE, a consortium of think tanks from rising democracies in the developing world. This is a bold initiative and the aim of learning from three vitally important countries – India, Brazil and South Africa – is an ambitious endeavour. The consortium will structure its work under the broad umbrella theme of democracy and inclusive growth. We intend to learn more about each other's countries and look for comparative insights. This new knowledge will be used to strengthen each think tank's activities in promoting domestic reforms in their own country; and our comparative country insights will be used – in time – to influence other developing countries and the global conversation about development strategies, priorities and achievements *(see appendix A for information about the three think tanks)*.

The dominance of highly-industrialised developed countries, their politicians, media, intellectuals, and experts in shaping global conversations about development and growth is striking to those who live outside traditional global centres of power and influence. Policy agendas influenced by these countries are often out of touch with the realities of developing countries.

INCLUDE held its first public event – a workshop involving all three think tanks, and leaders in business, government, academia and others – in Johannesburg, South Africa, in 2011. The workshop explored key issues in the three countries focusing on the role of states, business, and markets in achieving higher and more inclusive economic growth *(see appendix B for a list of participants at the workshop)*.

This first workshop demonstrated the vital importance of getting beyond the slogans, the PR images of countries, and into the particularities of what is actually happening. India, Brazil and South Africa are three very different societies on three complex and diverse continents. All are democracies wrestling with the challenges of driving economic growth, dealing with mass poverty, the politics of inequality and the dynamics of rapid social change.

What has been called 'the rise of the rest', that is, the developing world, will have economic, political and other consequences. There are new ideas, new approaches to development and new experts emerging in India, Brazil, South Africa and elsewhere. INCLUDE aims to learn, document and build insights from this set of experiences.

In this short summary of a longer report, we will describe some of the challenging and interesting ideas and insights arising from this first workshop.

States and markets

This topic encourages considerable rhetoric and ideological positioning. It is important to dig deeper and think harder about the realities behind the bombast. We need to debunk false dichotomies between the market and the state.

The advocates of the so-called 'Washington Consensus' for developing countries themselves often lived in industrialised countries with very large states. Even before the 2008 economic crisis, many Western countries had states that accounted for nearly half of GDP.

All three countries encompassed by this initiative have very large state sectors. In India the state sector remains dominant, at over 50 per cent of GDP. In Brazil, under military rule in the 1960s to 1980s, state-owned enterprises multiplied, and although significant areas of the economy have been privatised, large sectors are still in state hands. In South Africa, modest attempts at privatisation ground to a halt in about 2004, and many important economic sectors (including electricity, rail, road, air transport, and ports) remain state-dominated.

How the state manages globalisation in relation to market forces differs in each country, and is expressed in different institutional arrangements. The debate within each society about these issues and the national interest is ongoing.

Effective market economies require smart states. Governments that ensure excellent infrastructure can greatly boost market dynamism; governments that ensure quality education for all their citizens reap massive returns. However, this requires state officials who are competent, able to manage large systems and complex projects, and able to regulate sophisticated companies. It also requires politicians and state officials who want markets to work and can accurately gauge the complex relationship between effective state performance and market-friendly intervention. In too many instances the three countries are experiencing great incompetence and inefficiencies in their state sectors, or a political desire for a more activist state that hampers rather than facilitates the development of markets. Reforming large public sectors in these societies is a huge and common challenge.

Business and government

There is too much loose talk about markets, states, business and government. These are not interchangeable terms.

The role of the business sector in economic reform differs greatly in each of the three countries, in part as a result of their particular histories. However, in all three, large companies have had to move away from the special deals that characterise undemocratic situations or highly state-oriented systems, to participating in the public debates about general rules for governing economic activity and corporate opportunity. There are therefore increasing areas of common interest and comparability across the three countries concerning how companies participate in the democratic public square.

All three societies need to assess for example whether the liberalisation of their economies is leading to state capture by powerful business interests, and if so, how this can be countered or contained. Corruption is a growing challenge in all three cases.

Democracies with a free press and vigorous civil society organisations have an advantage in this arena. Laws can encourage transparency, watchdogs can be established, and the media can report on corruption, thus encouraging remedial action by the state, or allowing voters to know what is happening. However, enforcing vigorous and intense competition among companies (and political parties) is probably one of the most powerful tools for preventing business from capturing the state. Public education about the value of competitive processes would also make a difference.

Economic growth changes attitudes

The impact of higher levels of economic growth on a particular society can be profound, and the workshop yielded some striking examples.

In Brazil, as the economy started to grow and people saw new opportunities opening up in the private sector, their expectations of the state changed. With the expansion of the middle classes, an increasing part of the population buys market-based education and health services (private schools and health insurance). While new members of the middle class still worry about the provision of public basic health and education, they are ever more concerned with access to and effective regulation of private providers.

The growth of Indian multinationals has changed the way in which other countries and companies view not just those Indian companies but the country itself. India is now seen as a much more attractive place in which to do business than before. Within India, leading edge companies have become 'national icons' – an unexpected and remarkable phenomenon, considering India's past. The corporate leader as national hero is a different approach to traditional development theory.

Many South African companies have expanded successfully into Africa, and some have become global players. Many of these companies regard themselves as 'ambassadors' for the country and even the continent, spearheading a new era of African growth and potential.

The challenge of sustaining reforms

One set of challenges needs to be overcome when embarking on economic reform, and another when attempting to maintain the momentum of reform.

In all three countries, market-oriented reforms have taken place over the past 20 years, yet much more needs to be done. All three have introduced sensible macroeconomic management; but the vital micro reforms that complement, provide momentum and give meaning to this macro consensus have not been followed through or taken far enough.

All three countries face enormous threats to their competitiveness. Compared to China, for example, they lag in respect of infrastructure (Brazilian airports, South African ports, Indian roads); the quality of schooling (although Brazil is now seen as one of the fastest improving systems from a low base); and both Brazil (less so) and South Africa lag badly with respect to higher economic growth rates so essential to drive inclusive growth and sustain democracy in these societies.

The genius of politicians – as opposed say to economists – is that their expertise lies in 'seizing the moment', opportunistically turning a crisis into an opportunity and moving situations in a new direction. They have reform proposals ready for when situations allow new ideas to emerge and transcend the obstructive or vested interests so that the unpopular can become a new unavoidable and necessary priority.

Successful reform requires the development of a supportive coalition of interests around the reform process so as to maintain the necessary momentum. Some Indian states are doing this better than the federal government, and Brazil seems to have built some momentum for reform across party lines now being tested in the third reform presidency of Dilma Rouseff. In South Africa reform seems stalled for now as internal debates within the ruling alliance take centre stage at the expense of effective leadership of the country.

Inclusive growth

This fashionable new phrase is used by the governments of India, Brazil and South Africa, but is seldom clearly defined.

In all three countries, social mobility is a reality with political consequences. Brazil recently had a president who rose from the dirt-poor north east of the country to the very top of society, and a vice-president from a similarly disadvantaged background. South Africa's president and many members of its cabinet come from poor families. The Indian prime minister is the exception, rising from that country's very well-educated elite, but the heads of many regional states come from the most deprived groups in India, including the formerly 'untouchables'.

In India, 'inclusion' has been seen in a number of ways. The Indian constitution of 1950 outlawed social exclusion through the caste system, and this has been coupled with aggressive affirmative action. Economic inclusion has included traditional redistribution, including land reform that has not gone very far; and the development of a safety net which comprises the national rural employment guarantee scheme, a subsidy for food grains, and a public sector distribution system.

The more interesting and sustainable aspects of inclusion in India involve growth and private activity. As economic growth has accelerated, the question of who participates in this growth has emerged.

The second aspect of inclusion in India has been demand-led. The phenomenal expansion of private schooling across a range of income categories from the poorest upwards is a powerful example. Parents are 'voting with their feet' to provide their children with access to English-language education, which they know is vital for economic success.

Brazil has adopted an innovative approach to welfare. The formal economy is based on a minimum wage and pension schemes linked to inflation. With respect to the mainly rural poor, the state has pioneered the BolsaFamilia programme providing very small amounts of money to a well-targeted population on condition that children attend school and receive regular vaccinations against preventable diseases. However, there is a debate about the respective roles of minimum wages, and BolsaFamilia, in the spectacular growth of a new middle class of some 30 million people. There is also growing concern about whether the formal system is affordable, and therefore sustainable.

South Africa has built up what is probably the most extensive and expensive welfare state in the developing world. It now encompasses some 15 million people, and involves a variety of unconditional grants: for child support, housing, land, free basic services, and old age pensions. The impending introduction of a national health insurance scheme is raising sharp questions about affordability, and sustainability. The country is also witnessing the development of private schooling for the poor.

Distributionist policies to reduce inequality have a very mixed record. Nonetheless, inequalities of opportunity are a vital issue in all three societies.

Economic growth can be more or less pro-poor. Policies favouring economic growth should be the principal means of reducing poverty. Nonetheless, poverty can be reduced under lower rates of growth, depending on the public policies adopted. Brazil experienced lower growth rates in the last 15 years than under the military regime, but reduced poverty more rapidly.

This implies that there should be other policies to attack poverty. Policies on health and education are particularly effective. And there is new evidence in all three countries of the success (and sometimes the failure) of additional approaches aimed at providing mechanisms to help poorer people get into the modern economy and its wealth of opportunities.

Jobs and labour legislation

All three countries have rigid and restrictive labour laws. The pressures for reform differ in each situation.

Remarkably, despite high levels of growth in India during the past 10 years, the proportion of formal sector jobs to informal jobs has not increased. The informal, unregulated sector appears to be interlinked with the formal economy in unusual ways, and is a central component of the high growth story.

In Brazil the rigidity of the labour market is a factor in making the informal and unregulated sector of its economy very large. Nonetheless, the country has managed to grow formal sector jobs.

South Africa has a surprisingly small informal sector, with insufficient clarity on why this is the case – whether this is a question of definition, the legacy of apartheid, or some other factor has not yet been resolved. The three think tanks will work on this area in the future.

In all three countries there seem to be two large agendas often working simultaneously. The first is a set of attitudes and associated reforms favouring deregulation; the second is a set of pressures, vested interests and legislation that are consciously and sometimes inadvertently opposed to markets and greater market access. Consequently market reforms, particularly at the microeconomic level, assume a stop-start character (India opening up to international supermarkets; Brazil and South Africa leaning in a more statist direction at present).

Urbanisation, land reform, and the demographic dividend

Brazil is now over 80 per cent urbanised, and is simultaneously seeing a dramatic growth in 'the new middle class' and a reduction in poverty. By contrast, both India and South Africa are ambivalent about urbanisation.

Nandan Nilekani, former CEO of one of the iconic Indian IT companies, Infosys, has written eloquently about the demographic dividend that could be reaped in India if millions of young people were given a decent education and economic opportunities. This is also possible in South Africa, but this potential is being squandered by the massive unemployment rate among young people, the poor education available to most of them, and a health crisis involving AIDS and tuberculosis, which mainly affects younger South Africans. In both countries, bold policy reform could lead to enormous progress.

Brazilian society, on the other hand, is starting to age, which will present policy-makers with a different set of challenges in time.

In all three countries, issues of land reform are important and partially unresolved. In Brazil this is more important in urban than rural areas. The country has achieved considerable progress in providing rural workers with land in agrarian reform settlements. Nonetheless, after 15 years of intense land reform less than 10 per cent of rural settlements of ex-landless people are sustainable without permanent public funding. In South Africa agriculture is a small and declining part of the economy, in part a result of the negative consequences of a badly-managed land reform process. India is slowly experimenting with the introduction of modern supermarkets with their supply chains, thus moving away from a situation in which some 30 per cent of farm goods are wasted or destroyed before getting to market.

It is hard to see how the modernisation of the rural economy in India, South Africa, and probably parts of the Brazilian northeast, can take place without grappling with the issues central to land reform: inequity and access in a competitive global economy; and finding the best possible route to modernisation with respect to traditional land holdings.

New models of development

Whether a new development approach is discernible in these three democratic, middle-income developing countries is not yet clear. Each country is uneven in its stage of development, and more information is needed about major economic sectors.

More broadly, all three countries display a desire for market-driven development. However this is coupled with a historically large state, and a preference for the state to play a major role in strategies for growth as well as the inclusion of more and more people in the modern economy and society. To what extent this is what has traditionally been described as a mixed economy, or the development of new form and content in the developing world, remains to be seen.

At the same time, some of the interesting new developments do not always include the state. Thus 'private coping', such as the growth of private schooling for poorer people in India (where it is massive) and South Africa (15 per cent of schools and growing), is one example of how market dynamics are responding to demand.

A second area is the impact of employment. Contrary to the many well-meaning and often state-driven or foreign-funded ideas of how to help the poor, it is clear that employment is often the best way out of poverty and into a world of skills and new opportunities, albeit – initially – at a very low level. The 90 million people moved out of poverty in India over the past 20 years provide a striking illustration that faster economic growth and more market opportunities offer the most sustainable and empowering route out of poverty.

'Poetry and plumbing'

A country's future is often determined by leaders' attitudes to the outside world and the policies and strategies that flow from that. It is also determined by the vision which leaders offer their citizens. If poorer people or formerly excluded groups feel they are now part of the development story, their attitudes change, they dream bigger for themselves and their children, and in so doing can drive their society to greater heights. The skill of leadership is to make sure that people are encouraged to think big and that the new opportunities in education, employment and urbanisation are available and working to best effect for as many people as possible.

Development policy inevitably involves a lot of 'plumbing' – sober, often highly technical implementation, and tinkering with the physical and institutional conditions under which people live. Political leaders who are nothing but 'plumbers' are unlikely to inspire the efforts, and often the sacrifices, necessary for development. 'Poetry', the vehicle of dreams, is also called for.

Democracy and development

Key to this workshop – and the INCLUDE project – is the issue of whether democracies such as these provide desirable and effective settings for development and inclusive growth.

All three countries are robust democracies. India has been a democracy since independence, with the brief interruption of Indira Gandhi's emergency rule. Brazil had a long democratic tradition to which it returned after the demise of the military dictatorship. South Africa created a non-racial democracy after the negotiated demise of its apartheid regime.

There is no guarantee that these three countries will remain democracies forever. However, there are few indications that democracy is under threat in any of them. India and Brazil have had democratic alternations of political power, with an opposition party succeeding an incumbent group. Although South Africa has not yet passed this test, the fact that four very successful national and four separate local government elections have been held is a good omen.

Their records in terms of inclusive growth are uneven. Both India particularly, and to a lesser extent Brazil, have grown more rapidly than the South African economy (the relatively recent end of apartheid and some anti-growth policies may help explain this discrepancy). In part because of this discrepancy, the reduction of poverty in the first two countries has been much more spectacular, although in Brazil conscious social policies have evidently played an important role too.

In recent years tens of millions of people have moved out of extreme poverty in India and Brazil. Social mobility in South Africa has been more modest; nonetheless, large numbers of poor people have experienced greatly improved access to basic services such as running water, electricity, and health care, and the indicators of inclusion point upward.

The stories of the three countries already provide solid evidence for the affinity of democracy and inclusive growth. And during the next few years this consortium of think tanks from India, Brazil and South Africa will continue to explore the proposition that democracy provides the most effective and desirable vehicle for growth and development in complex, plural societies in the developing world.

This is an executive summary of a Round Table report, *DEMOCRACY AND INCLUSIVE GROWTH: States, markets, and enterprise* (March 2012). The full-length publication is available from the Centre for Policy Research www.cprindia.org, the Instituto Fernando Henrique Cardoso www.ifhc.org.br and the Centre for Development and Enterprise www.cde.org.za.

Appendix A: Information on INCLUDE think tanks

Centre for Policy Research (India)

The Centre for Policy Research (CPR) is an autonomous, non-profit, non-partisan research organisation and a leader in Indian public policy research. CPR's major strategic objectives are to investigate policy issues facing the Indian polity, economy, and society; build a comprehensive body of policy-relevant knowledge; and provide policy alternatives. In order to achieve these goals, CPR works in close co-operation with policy-makers, academic policy researchers, and the media. It also manages several special-interest research initiatives. One such initiative is the Accountability Initiative, which regularly tracks and provides reliable and accessible information about the implementation of service delivery programmes in India. CPR also seeks to inform the accountability debate in India, thereby strengthening accountable governance and citizens' engagement in India's governance processes.

Instituto Fernando Henrique Cardoso (Brazil)

The Instituto Fernando Henrique Cardoso (iFHC) was founded in May 2004 by former Brazilian President Fernando Henrique Cardoso. Bringing together politicians, intellectuals, civil society, and young people, the Institute aims to produce and disseminate knowledge about the challenges of development and democracy in Brazil and the wider world, especially Latin America. The research focus is on economic and social change and the challenges they pose to democracy. The Institute does not limit its focus to economic issues, but is more concerned with political and socio-cultural dynamics.

Centre for Development and Enterprise (South Africa)

The Centre for Development and Enterprise (CDE) is an independent policy research and advocacy organisation, widely recognised as 'South Africa's most respected policy centre for social and economic development' (*Financial Times*). CDE undertakes research on key development issues and their relationship with economic growth and democratic consolidation. With core funding from South African companies, CDE has a special focus on the role of business and markets in development. Comprehensive assessment of South African realities and international experience enables CDE to formulate practical policy proposals that outline the ways in which South Africa and other middle-income developing countries can tackle social and economic challenges. With 17 years of experience in research and innovative policy analysis, CDE has established itself as an authoritative voice in policy debates, has a remarkable ability to capture media attention, and is read and heard at the highest levels of government.

Appendix B: Participants, Round Table, 7 March 2011

Prof Peter Berger, *Senior Research Fellow, Boston University*
Ms Ann Bernstein, *Executive Director, Centre for Development and Enterprise*
Mr Fuad Cassim, *Special Advisor to the Minister of Finance, National Treasury, South Africa*
Mr Watana Chuttong, *First Secretary, Royal Thai Embassy, South Africa*
Mr Alfredo Cuevas, *Senior Resident Representative, International Monetary Fund*
HE Mr José De Sá Pimentel, *Ambassador of Brazil to South Africa*
Mr Amaury de Souza, *Fellow, Centro Brasileiro de Relaçõs Internacionais*
Mr Vikram Doraiswami, *Consul General of India to South Africa*
Mr Peter Draper, *Research Consultant, Centre for Development and Enterprise*
Dr Sergio Fausto, *Executive Director, Instituto Fernando Henrique Cardoso*
Mr Bobby Godsell, *Chairman, Business Leadership South Africa*
Prof Robert Lawrence, *Professor of International Trade & Investment, Harvard University*
Mr Joaquim Levy, *Director, Brandesco Bank, Brazil*
Mr Mandla Madi, *Commissioner, SOE Presidential Review Committee*
Dr Pratap Bhanu Mehta, *President and Chief Executive, Centre for Policy Research*
Ms Bridget Mohlala, *Director Social Dialogue, Department of Economic Development, South Africa*
Mr Lumkile Mondi, *Chief Economist & Head of Research, Industrial Development Corporation of SA*
Ms Futhi Mtoba, *Chairperson, Deloitte, South Africa*
Dr Partha Mukhopadhyay, *Senior Research Fellow, Centre for Policy Research*
Prof Mbulelo Mzamane, *Commissioner, SOE Presidential Review Committee*
Ms Dorin Nelson, *Country Representative, Confederation of Indian Industry*
Ms Gugu Ngcobo, *Commissioner, SOE Presidential Review Committee*
Mr T N Ninan, *Chairman and Editorial Director, Business Standard Ltd*
HE Mr Toshiro Ozawa, *Ambassador of Japan to South Africa*
Mr Sipho Pityana, *Executive Chairman, Izingwe Capital (Pty) Ltd*
Mr Andile Sangqu, *Executive Director, Xstrata Coal*
Dr Khathu Sikhitha, *Senior Economist: Economic Planning, Department of Economic Development*
Mr Mike Spicer, *Chief Executive Officer, Business Leadership South Africa*
Mr Peter van der Bijl, *Chief Operating Officer, Reunert Ltd*
Mr Brendan Vickers, *Chief Director, Department of Trade & Industry, South Africa*

CENTRE FOR POLICY RESEARCH
Premier think tank shaping
policy debates since 1973

Dharam Marg, Chanakyapuri, New Delhi – 110021
Tel: 91 11 26115273 76 (4 Lines)
Fax : 91 11 26872746
cprindia@vsnl.com
www.cprindia.org

---

instituto
iFHC
FERNANDO HENRIQUE CARDOSO

Rua Formosa, 367, 6º andar, Centro, São Paulo/SP, Brasil
CEP: 01049-000
Tel: 55 11 3359-5000 – PABX
Fax: 55 11 3225-9024
ifhc@ifhc.org.br
www.ifhc.org.br

CENTRE FOR DEVELOPMENT AND ENTERPRISE
Informing South African Policy

5 Eton Road, Parktown, Johannesburg, South Africa
P O Box 1936, Johannesburg 2000, South Africa
Tel: 27 11 482 5140
Fax: 27 11 482 5089
info@cde.org.za
www.cde.org.za