Development and Democracy

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Perspectives on business, economic growth and civil society

THE CENTRE FOR DEVELOPMENT AND ENTERPRISE

DEVELOPMENT AND DEMOCRACY

Development and Democracy is one of a series of publications produced by the Centre for Development and Enterprise. As the successor to the Development Strategy and Policy Unit (DSPU) of the Urban Foundation, CDE has inherited the journal *Development and Democracy*

Development and Democracy is an occasional publication of opinion, commentary and research. Each issue focuses on a selected theme central to the national debate on development, democracy and economic growth. The editor will invite submissions on a particular theme or for an entire issue from many quarters. In addition, we will respond positively to readers who react to views or material published in the series.

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The Role of Business Series

Over the past two years, the Institute for the Study of Economic Culture at Boston University (directed by Peter Berger) and the Centre for Development and Enterprise in South Africa (directed by Ann Bernstein), together with Bobby Godsell of the Anglo American Corporation, have undertaken a cross-national study of the role of business in transitions to democracy and in socio-economic development.

The countries covered in the study are Brazil, Mexico, Spain, Indonesia, the Philippines, Nigeria and South Africa, augmented by an analysis of the racial transition in one city – Atlanta, Georgia. Besides the country studies (primarily of developing countries), papers have been produced on a number of themes, viz business and 19th-century transitions to democracy; business in ethnically divided countries; business and economic growth; business and civil society; and business associations in developing countries. [1]

Throughout 1996, CDE will publish a series of executive reports on the Role of Business project. There will be five such reports in total, covering the main findings and research and then applying the insights and ideas obtained to the South African situation.

The first document in the series, *Business and Democracy: Cohabitation or Contradiction?* is a general overview of the insights, conclusions and general recommendations concerning business and its role in growth, development and democracy

This, the second document in the series, focuses on three of the most important papers written for the project.

The Role of Business project has been sponsored by a number of South African corporations, the Institute for the Study of Economic Culture at Boston University, and the Urban Foundation.

'Success in development is primarily determined by government policies that shape the environment in which business operates. The principal contribution of business, then, would lie in exerting a positive influence on government policies.'

Perspectives on business, economic growth and civil society

This, the second in a series of publications on the role of business in transitions to democracy, examines direct and indirect consequences of business operating as a social actor. The first paper, Business and strategies for successful economic development, focuses on the centrality of growth in reducing poverty and business's role in such growth, and is written by Prof Gus Papanek. In the second paper, Transitions to democracy in European history, and business's role, Michael O'Dowd outlines business's often equivocal role in transitions to democracy from an historical perspective. The final paper, 'Thickening' civil society, written by Prof Gordon Redding, head of the University of Hong Kong's Business School, explores business's less visible role in strengthening civil society by drawing on the impact of multinationals in China.

All three papers have been edited by Judith Hudson, research co-ordinator at CDE, and draw on the first report in the Role of Business series, which provides the conceptual framework for considering business as a social actor.

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Views expressed in this publication are the views of the respective authors, and are not necessarily those of the Centre for Development and Enterprise.

'Unintentionally normal business activity demands, requires and in turn creates a 'thickening web' of institutions, organisations, self-regulating mechanisms and professionals that comprise important components of civil society outside the state.'

Business and strategies for successful economic development

Gus Papanek

Gus Papanek is president of the Boston Institute for Developing Economies, and professor emeritus of economics at Boston University. One of the world's leading development economists, he has undertaken major projects for the World Bank, USAID Harvard University and the Ford Foundation, among others, as well as for a number of developing countries such as Indonesia and Pakistan.

The crucial difference between countries that develop successfully and those that fail lies in the economic strategy adopted. Korea, a failure until 1962, has been a blazing success since then: same country, different policies. India had all the elements of success in the 1950s, but the wrong strategy resulted in failure. Between 1965 and 1990 South Asia had a growth of only 1 percent per capita per annum. By contrast, in East and South East Asia, growth reached 5 percent per capita per annum for the same period. The difference lies in strategy. Culture matters; so does political stability, natural wealth and so on. But some of these are helped or changed by growth. There are other factors that nothing anyone can do will affect – for example, you either have oil or you do not; people are naturally thrifty or they are not. By contrast, economic policy is under a country's control.

The experience of the last 40 years is clear: in developing countries, substantial transfers of income or wealth from the rich to the poor will, firstly, be fiercely resisted. Secondly, the administrative machinery is weak at taking from the rich – the political leadership, bureaucracy, officer corps, landed aristocracy and business community all tend to be part of the same small elite, indeed often of the same family. It is asking a great deal for the political leadership to adopt policies for taking income or wealth from family and friends, for the bureaucracy to administer such a programme, and for the officer corps to support it when it hits home or close to home. Thirdly, for some of the same reasons, the machinery finds it difficult to give to the poor. For both political and administrative reasons, it is harder to redistribute a very small than a very large pie. Poor countries need more powerful incentives to develop, and transfer payments usually weaken incentives. In general, transfers from the rich to the poor have therefore taken place only after a revolution, which has its own economic costs.

The only viable alternative, therefore, for rapidly and consistently increasing the income of the poor majority is to enable the poor to earn more, and they can only do this if there is greater demand for their labour, their primary source of income. The more rapid and labour-intensive the growth of the economy, the faster jobs will be created.

This paper focuses on strategies for growth, and offers some insights on the role of government and the business community. It is argued that success in development is primarily determined by government policies that shape the environment in which business operates. The principal contribution of business, then, would lie in exerting a positive influence on government policies. Until recently the business community has not played a major role in shaping and supporting reforms. It is an interesting question why that should be so. Before discussing an appropriate role for business, and the problems that business experiences in playing that role, one needs to analyse what constitutes success in development and what policy framework is needed for such success. 'Success' cannot be defined in purely economic terms; it also has a political dimension. These issues will be discussed in turn.

THE ECONOMICS OF SUCCESSFUL DEVELOPMENT

Empirical evidence quite clearly supports two propositions. Firstly, rapid growth can occur in a country for a decade or so with the benefits narrowly distributed and without the establishment of a sustainable process. Many countries achieved high growth rates in the 1970s, for instance, but grew slowly or declined in the 1980s. This group included countries in Africa (eg Ivory Coast, Gabon, Egypt, Cameroon), Latin America (eg Equador, Paraguay, Brazil), and Asia (eg Syria, Saudi Arabia). In most countries of unsustained, narrowly focused growth the output increase depended on windfall gains from high prices for raw material exports (eg oil), heavy borrowing, massive foreign inflows, or all three. If these inevitably temporary windfalls were poorly utilised, frittered away in conspicuous consumption or wasteful investment, the period of rapid growth was inevitably followed by a period of stagnation. Prices that had risen dropped again, loans became due, foreign investment and aid slowed, unwise investments required continued costly subsidies, and consumption levels, once ratcheted up, proved difficult to ratchet down again in response to tighter circumstances.

But if rapid growth continues for two decades, the process is likely to become self-sustaining and continuous, with widespread benefits. Such lengthy growth almost inevitably creates a rapidly rising demand for labour of all kinds, including unskilled labour. It therefore raises the labour income for unskilled workers, which means most of the poor. In addition, such persistent growth is rarely based on windfall gains only. After two decades of growth, a country usually has assured continued growth by·

Contrary to the argument by those who believe that 'small is beautiful' and that 'trickle-down does not work', rapid growth is good for the poor.

- adopting policies that encourage entrepreneurial activity and savings;
- developing a set of institutions and habits that favour growth;
- making investments in human and physical capital that are productive and have a competitive advantage in that country·
- learning to compete internationally· and
- generating widespread support for the growth strategy the country has adopted because of the widespread benefits which it has brought, thus allowing the strategy to continue.

All of these attributes yield continued economic returns when the windfall ends, and/or generates the growth in the first place, even in the absence of such a windfall.

THE POLITICAL ECONOMY OF SUCCESSFUL DEVELOPMENT

Without widespread support, government cannot continue to give priority to development, and cannot pursue policies that cause short-term pain to important groups but are required for long-term gain. For a development strategy to be perceived as successful, and maintain political support, it has to achieve at least four objectives. These are to:

- *raise the income of the majority of the population*, of whom many in developing countries are poor;
- *mitigate inevitable short-term setbacks to the economy and reduce the impact of external shocks*, eg droughts, floods, rising import prices or falling export prices, and so on;
- *limit the conspicuous consumption of the rich, which will contribute to political stability* and encourage saving and investment; and
- *give hope to those who will remain poor for some time.*

The key to achieving these objectives is rapid, labour-intensive growth that creates strong demand for unskilled labour. Indeed, contrary to the argument by those who believe that 'small is beautiful' and that 'trickle-down does not work' rapid growth is good for the poor. Most important is the accumulating evidence that poverty generally declines in countries where per capita income grows rapidly, while the number of poor increases during periods of stagnation or a decline in per capita income. There are exceptions, but they are exceptions. Indeed, there is sound evidence that rapid growth benefits the poor more than it does the rest of the population. There is one exception, one caveat: the poor benefit only if growth is labour-intensive; if it creates demand for their labour.

But does the poor majority matter?

Yes. For a development strategy to be sustainable, it must be perceived to be successful by the overwhelming majority of the population. It has been argued that authoritarian governments are preferable for rapid early development, however regrettable this may be. An authoritarian government, the argument goes, does not have to worry too much about what the majority thinks. It can therefore ruthlessly pursue the needs of growth, squeezing a maximum of resources out of the population to speed up the process. In the longer term, everyone will be better off because the short-term well-being and the political support of the majority could be ignored.

This argument has two flaws: first, there is no guarantee that an authoritarian government will use its powers to benefit the population, albeit in the long rather than the short run – or even that it will regard economic development as an important objective, compared to, say, enriching itself in the short run, whatever the cost. There are as many examples of authoritarian governments pursuing short-term self-interest as there are of such governments pursuing their nations' long-term interest, which implies some attention to economic growth.

Second, there is evidence to suggest that even authoritarian governments need to pay attention to the economic well-being of the majority of the population. In the medium term of three to seven years, democracies tend to vote out of office governments that do not improve economic well-being. Under authoritarian governments, when elections are non-existent or rigged, people express the same dissatisfaction through riots or similar expressions of popular mood. A charismatic and populist leader who offers hope instead of bread or rice can sometimes stave off the day of reckoning, but not for long. One ruthless enough may be able to suppress discontent for a long time, given modern methods in this field, but it remains a high-risk gamble to assume that the economic welfare of the poor majority in poor countries can be ignored for any length of time. Discontent cannot be suppressed forever.

Compensating for inevitable external shocks

All the success stories have had setbacks, and will continue to have periods of slow growth or even decline. Sooner or later economies will suffer sharp declines, however well-managed they are. Even Japan must slow down at some point; no country can continue to grow indefinitely at 4 percent per annum. Some may yet take a fatally wrong turn. Droughts, floods or natural catastrophes may occur, the price of an important import (eg oil) may rise, the price of the most important export may fall, or there may be a slump in the economy of the most important trading partners, resulting in a drastic loss in markets. In developing countries, declines in income of 15–40 percent are hard to bear, especially if expectations have been raised by an earlier period of improvement in income. If these are not mitigated or counteracted, those affected will usually blame the economic policies of the government rather than the external cause, with serious consequences for popular support of the government and its economic strategy. Conversely, the favourable political reaction will be especially strong if income rises after a period of stagnation. Expectations and commitments will be low, and people will be pleasantly surprised by the unexpected improvement in their economic well-being. Therefore, it is the successful government with an effective strategy, or one that for other reasons has aroused the highest expectations, that needs to be most concerned about unexpected short-term setbacks to the economy. Rapid growth creates the wherewithal for government to set aside the reserves needed to prevent sharp declines in income.

The ability to absorb external shocks is a crucial difference between successful and less successful countries.

The ability to absorb external shocks is a crucial difference between successful and less successful countries. A comprehensive strategy therefore anticipates the inevitability of external shocks to the economy, and adopts policies before they occur that will mitigate their effect. This is an action that only a government can perform.

Limiting conspicuous consumption of the rich

Substantial disparities in income and wealth are inevitable in a capitalist system. They tend to be large, visible and hard to bear in developing countries. The continued poverty of the majority can lead to political tensions if the poor are constantly reminded of these disparities by the conspicuous consumption of the rich. Such tensions are further exacerbated if rich and poor are largely from different ethnic groups, and if mobility between them is limited.

Differences in income usually do not matter, because income is not visible; but differences in consumption can be quite evident, particularly if the rich engage in conspicuous consumption. Limiting visible consumption not only contributes to political stability: it also encourages saving and investment. If consumption is difficult and costly because it is heavily taxed or otherwise restricted, then saving and investing one's income will generally be more attractive. Savings rates of 50 percent or more out of industrial profits have been achieved under these circumstances. It is true that limiting conspicuous consumption is politically easier to achieve if the income of the middle- and upper-income groups is rising rapidly, as a corollary of rapid growth.

Giving people hope

Even if per capita income is rising at 4 percent or more a year, a high rate in terms of recent achievements, it will take a generation or two for most of the poor in developing countries to surmount absolute poverty.

Therefore, it matters a great deal whether they hope for improvement for themselves, or at least for their children. One factor that generates hope for the future is a steady and visible improvement in income, which has already been discussed. Two other factors that significantly affect hope are:

- whether children in the family have access to education, universally seen as the principal passport to a better life, and to reasonable medical care, so that they are likely to survive to adulthood; and
- whether government is seen to care about the wellbeing of the majority of the population, or is seen as indifferent and only concerned with the elite. Avoiding rampant corruption is important, for this reason as well as for efficiency. Reasonable pay for government employees can help to limit corruption, and is more readily financed in a growing economy.

Another factor that helps to determine how government is perceived is the image projected by its leadership. For example, if many people are suffering because of temporary exogenous shocks, while government claims all is well, then the conclusion that people can justifiably reach is that the government in power is either ignorant of or indifferent to their lot. On the other hand, a leader can show concern by emphasising that he knows people are suffering and is determined to improve their situation, and by announcing populist measures. The measures may be largely cosmetic, and may have long-term costs for the poor, but in the short term they may generate a good deal of support.

THE IMPORTANCE OF AN APPROPRIATE ECONOMIC STRATEGY

Rapid, labour-intensive growth is the key to alleviating poverty, mitigating the effects of external shocks, and providing the resources to ease social tensions. Its achievement depends fundamentally on a set of government policies and strategies that do not aggravate market imperfections and distortions but that compensate for them, and which allows market incentives to determine the behaviour of individual firms. The strategy adopted is decisive.

There is a remarkable intellectual consensus, probably for the first time this century, on the desirability of a relatively limited role for government and a prominent role for market forces. However, some disagreements remain over the extent to which government should intervene in positive ways to achieve an even better performance. The disagreement centres on four issues:

- *The extent of government management or control.* Some activities, primarily the provision of infrastructure and social services, tend to be natural monopolies: these typically include public health, roads, railways and communications. There is general agreement that such natural monopolies must either be operated by government, or that government needs to exercise some control over their prices. The disagreement is over whether ownership/operation or control is more desirable. In any case, policies on these issues are generally not crucial in determining whether development is successful or not.
- *The role of industrial policy – 'picking winners'* The extent to which government is better able than private enterprise to determine in which industries massive investment is in the long-term interest of a country, is very controversial. The proponents of industrial policy point to the success of Japan, Korea, Taiwan and, to a lesser extent, countries in South East Asia in support of their position. The opponents point to two dangers of this approach:
  - governments can make mistakes in 'picking winners' indeed they are more likely to make mistakes, since they are not risking their own money· and
  - governments may persist in mistaken policies for much longer than private firms would, since the political costs of admitting error may be

greater than those of backing their gamble with further public resources.

The opponents sometimes cite the same countries in support of their argument. Korea's decision to invest in energy-intensive industries just ahead of the oil price increases of the 1970s is a favourite example.

Advocates have recently made some headway by citing the achievements of the East Asian governments (including Japan and China) in promoting industries that became successful exporters. But in citing these examples, it is important to distinguish between the relative importance of a government role in picking particular industries, and its role in compensating for market imperfections.

- *Compensating for market imperfections.* Even the most dedicated advocates of private enterprise and the market recognise that the market is not perfect. The existence of externalities is particularly important: these include costs imposed by one economic actor on another, or benefits that accrue to those who did not generate them. A standard example, which has become increasingly important, is that of pollution created by one firm that raises costs for downwind or downstream firms and consumers. Less widely recognised as an externality is the cost of breaking into the world market for manufactured goods. Only society as a whole, acting through government, can compensate for the costs of economy-wide negative externalities, and develop positive externalities. This is also true in respect of other market imperfections. For instance, in the case of pioneer manufactured exports, government can provide a general subsidy to all firms that break into the world market with commodities that need to establish a reputation for quality. That subsidy would compensate them for special costs they incur simply because they are located in a country that has not historically exported such manufactures.

The governments of most East Asian countries have extensively intervened in the economy to compensate for market imperfections. Initially they protected infant industries to compensate them for the costs of learning by doing, and of the organised training that pioneer industries had to incur. A major element in the success of the East Asian countries was policies that quickly made exporting highly profitable, despite the additional costs incurred by pioneer exporters: these included a favourable exchange rate, subsidised credits, various other special government concessions, and import privileges or drawback schemes. Their governments also invested heavily in social and physical infrastructure, including education which combined the characteristics of natural monopolies and major externalities.

It can thus be argued that the success of East Asian, and of some South East Asian, countries was less due to the ability of government to pick industrial winners than to its policies, which compensated all firms for the costs of market imperfections. At the same time, firms were systematically exposed to competitive pressures, the only effective guarantee of increased efficiency and lower costs.

How much government intervention is desirable, and in what form, undoubtedly varies from country to country and over time. It is certainly affected by the strength and honesty of government, both the political leadership and the civil service, as well as by the particular country's stage of development. When appropriate policies and programmes are easily discerned and simple to execute, then government can be more effective than when the economy and the environment in which it operates are both highly complex and changing rapidly.

It is important to distinguish between the relative importance of a government role in picking particular industries, and its role in compensating for market imperfections.

The worst strategy

In an economy with abundant labour, substantial unemployment and underemployment and scarce capital and foreign exchange, the *worst* strategy·

- rations capital and foreign exchange, but makes them cheap to those able to obtain them;
- makes labour expensive to employ in the organised, large-scale sector; and
- tries to substitute government rules, controls, allocations and management for private incentives.

The net result is inefficiency, slow growth, and windfall profits for those who can turn the control system to their advantage by means of influence, pressure or bribery. Worse, an increasing proportion of labour cannot find productive employment, but ekes out an existence in low-paid casual and sporadic jobs. This results in increasing social and political tensions, as large numbers of people see no hope for their families.

Instead, they see the benefits of the system going to those with the best connections, not to those who contribute the most. Rent and permit seekers become the winners, not producers or innovators.

A better strategy

A *better* strategy leaves the functioning of the economy to the market, to private enterprise, with a minimal role for government. In that system, if labour is abundant and capital and foreign exchange are scarce:

- labour will be cheap, and therefore productively employed;
- capital and foreign exchange will be expensive, and therefore business will use them carefully and work hard to generate more; and
- private incentives will strongly encourage savings, hard work, risk-taking and innovation.

The system will generate relatively rapid, labour-intensive and efficient growth. Unskilled workers' wages will be uniformly low, but will rise over time. Some inefficiency will be introduced to the system by inherent market imperfections and failures, and by earlier government interventions leaving a legacy of distortions that do not disappear overnight. As in all capitalist systems there will be considerable differences in income and wealth, and consequent social and political tensions. These tensions will be exacerbated if much of the difference in economic success is not due to differences in ability or hard work but to past or current discrimination, inheritance, or past government favouritism.

The best strategy

The *best* development strategy leaves the ownership and management of enterprises in private hands, and lets the market determine prices and distribution decisions, but will see the government intervene to:

- compensate for inherent imperfections in the market, such as the externalities of breaking into the world market;
- compensate for distortions due to historical accident, past government interventions, or institutional rigidities, such as unemployment due to labour costs raised by past government interventions, or inadequate foreign and domestic investment because of a high level of perceived risk;
- regulate or operate natural monopolies; and
- reduce the tensions that arise if reforms were to cause extreme distress for some poor people, or if conspicuous consumption rises during periods of austerity and hardship for the majority – for instance, by carrying out large-scale, labour-intensive public works programmes financed by heavy taxes on conspicuous luxury consumption.

Reducing impact of external shocks

As regards reducing the impact of external shocks on the poor majority, there are three major steps that governments have taken:

- The most important measure has been to build up a *reserve stock of staple food grains*, thereby preventing sharp temporary increases in the prices of foodstuffs consumed by poorer people. This is difficult to manage: there is always the risk that the reserve stocks will be used not to even out temporary fluctuations but to try to counteract longer-term changes. Farmers will exert pressure on government to buy more of these staples than needed for stabilisation purposes, in order to increase their payments. If there are organised consumers, their interest will lie in government selling more of the staples than is prudent during periods of rising prices. Therefore, the most effective stabilisation agencies have had some degree of autonomy, and some clear guidelines on when to sell and when to buy.
- The best insurance against the other major source of external shocks arising in the world market is an *adequate reserve of foreign exchange*. Again, this is difficult to manage. It is politically difficult, but nevertheless important, for government to use some of the windfall gains to maintain essential imports when the inevitable downturn in foreign exchange earning or transfers occurs.
- Some governments have also put a *guaranteed floor under the price received by farmers for some major crops*. Without such a guarantee, many smallholders are unable or unwilling to take the risk to:
  - buy commercial inputs, such as fertiliser, on credit in adequate amounts, because they are afraid that the price they receive for their output may fall so much that they cannot pay off their loans, feed their families and retain their land; and
  - shift from the production of lower value food crops to the production of higher value cash crops, because they fear that price of food could rise enough, or that of the cash crop fall enough,

to make it impossible for them to buy the food they need and retain their land.

In combination, these three social insurance policies can dampen the extreme fluctuations in prices that would otherwise take place in the short run. Since the poor suffer especially from short-run inflation, such a strategy can reduce the sharp short-term setbacks to the purchasing power, or the real income, of the majority, which has such strong destabilising effects.

Flexibility is built into a well-functioning market, and into well-functioning government policy machinery. Centrally planned or highly controlled economies, with their bureaucratic decision-making process, find it much more difficult to deal with rapid change. Flexibility in government policy, especially in shaping the macro-economic environment, is also important. The most successful economies have had governments that adjusted quickly, and anticipated major changes in the external environment.

The strategy of distortion-correcting government intervention outlined above can achieve higher growth and greater labour intensity than one of complete laissez faire, or private enterprise. It therefore leads to a more rapid alleviation of poverty and defusion of social tensions. Besides this, it can directly reduce such tensions, and therefore also the chances of a backlash that could abort the reforms needed to achieve successful development in highly controlled economies. A crucial element in the success of such an economic strategy is the maintenance of political support. Reaching and maintaining a consensus on a dominant role for private enterprise and the market, in making decisions, setting prices and determining commodity flows, means that half the battle to achieve rapid growth is won before it is joined.

But the economic millennium has not arrived, and serious obstacles remain to the adoption of an effective strategy for rapid growth and poverty alleviation. For example, it is rare for cost-free reforms not to be implemented only because those framing policy are ignorant about their possible benefits. Usually there are clear, concentrated, immediate and cer-

Flexible responses to external shocks: the case of Indonesia [a]

The market is not good at anticipating and correcting in advance for the likelihood that income will decline. The oil price increase of the 1970s is a good example.

Oil exporting countries quickly developed an overvalued exchange rate. That made it unprofitable to produce goods that could be imported more cheaply, and made it largely unprofitable to export anything but oil (and other natural resources). Industrial and agricultural production declined unless they were heavily subsidised, while importing, trade, finance and supplying government's needs flourished. Private firms responded to market incentives and became importers, traders and government contractors. No individual could change the incentive system; they could only respond to it. When oil revenues dropped sharply in 1982, governments and private individuals in many countries maintained their accustomed expenditures by borrowing, until this became prohibitively expensive. These countries then had to go through a very painful adjustment process, made all the more severe by being delayed.

Indonesia handled the problem better than most, because of more sensible government policies. It invested some of the windfall revenues in education and infrastructure. Other resources went to subsidise, sometimes via protection against imports, some of the productive activities that otherwise would not have been profitable at the exchange rate determined by the oil windfall. When the bonanza came to an end, Indonesia had a much stronger productive base in place than would have been the case without the various subsidies. The system of subsidies was only fairly well-designed and was distorted by political and personal factors. As a result, it was far less efficient than it could have been. But it can be argued that if the market had operated without subsidies, it would have left the Indonesian economy as ill-equipped to respond to the decline in oil revenue as those of Mexico, Venezuela, Algeria and Nigeria. Moreover, once the dimensions of the problem became clear the Indonesian government devalued the currency by 60 percent and took a series of other steps that provided an effective, if hidden, subsidy to exporters. The environment was also made very attractive to foreign investors. The result has been an export boom that has pulled Indonesia out of its slump much more quickly than was true for most other oil producers. It grew at nearly twice the rate of the average fuel exporters. Indonesia's relative success was almost wholly due to the greater flexibility of government policy, combined with broad scope for market action.

tain costs to the groups that lose out as a result of reform. The benefits tend to be diffuse, uncertain and delayed. Opposition is therefore stronger and better organised than support.

THE ROLE OF BUSINESS

The argument thus far has been that successful development depends fundamentally on the economic environment, and incentives created by government policy. In a market system there is also a crucial role for business, and particularly for entrepreneurs, in management and innovation with respect to individual enterprises. But government policy critically influences whether business performs its function so that Adam Smith's 'invisible hand' assures that the pursuit of self-interest by each individual also effectively achieves benefits for society as a whole. If the incentive structure is sufficiently distorted, it is perfectly possible that the more effectively business pursues its self-interest, the more damage it does to the economy as a whole. Government policy plays a very important role in determining how efficiently private business functions in generating income and growth. It follows that the policies and strategies individual enterprises pursue are often less important to the speed and nature of growth than the role of business as a group in influencing government policy.

The policies and strategies individual enterprises pursue are often less important to the speed and nature of growth than the role of business as a group in influencing government policy.

Business contributes directly to economic development in a number of ways, for example through transferring technology, both internationally and within countries; subcontracting to smaller companies; accumulating investment capital; and establishing constructive labour relations. Besides this, private business is best able to provide the practical, specific and on-the-job training that is needed, but government needs to create the incentive structure so that the amount and nature of training provided is what is needed by the economy and society. That means that any firm which pioneers a particular form of training needs to be subsidised, to reflect the external benefits it creates for other firms that now benefit from a trained and experienced labour force without the need to incur training costs. The efficacy of business in transferring technology therefore depends heavily on government policies, and especially on whether government protects private firms from competition or adopts policies which ensure that private firms operate in a highly competitive environment. Government policies affect, in some cases fundamentally so, the important role business plays in training, in developing entrepreneurs, managers and technology, in promoting new business through subcontracts, and in accumulating investment. In market economies, a substantial share of all savings is generated by business.

But the environment that influences how much is in fact saved and, even more, how much is invested in the country concerned, again depends very much on government policy. Whatever the values and attitudes of a society, savings will be increased if luxury consumption is difficult and unattractive, because some goods are simply not available and others are expensive. If investment is attractive because it yields high returns with minimal political risk, that too will enhance savings. Conversely, if investment is risky and returns are kept low by government controls, while luxury goods are readily available at low cost, it will encourage both consumption and capital flight.

There are additional actions that individual firms can take that will have a positive effect on development. Firms acting on their own can stress competence rather than connections. But if firms operate in a competitive situation, or if they just want to maximise their profits, what they can do in these respects is strictly limited by the environment of government policies in which they operate. If government policies reward contacts, for instance, then firms too will need to be concerned with the influence their managers have, not only with their abilities. Therefore, the influence of business on government policies is what really matters. Even with respect to activities of business itself that affect growth, government policies matter a great deal. The crucial contribution of business, therefore, is to influence government policies. More importantly, if successful development depends primarily on the consistent implementation of an appropriate strategy, the most important role of the business community is to provide political support for such a strategy.

This is easier said than done. In most cases the medium-term interests of the individual business enterprises with respect to government policies run counter to the long-term interests of the business community as a whole, and the interests of society. There are several obstacles to business playing the political role that could make the greatest difference to the success of development, namely:

- The interest of the business community as a whole, its 'class interest' in Marxist terms, lies in less government involvement in the economy. But the interest of most firms lies in retaining, and even

India – why was business unable/unwilling to influence govt policy? [4]

India's post-independence nationalist government was persuaded that capitalism was inequitable, and that since indigenous capitalists were weak, the capitalist route to development would only strengthen the hands of imperialism in the guise of multinational corporations. The state, they believed, could be the principal engine for both growth and equity. The Indian business community passively accepted the socialist policies adopted by the government. There were three reasons for this:

- business leaders believed that, despite the radical tone and rhetoric of the Nehru government, a mixed economy would prevail;
- many businessmen believed they could personally profit under the proposed economic policies; and
- business believed it was futile to fight against the widely held negative beliefs about the private sector.

Thus business made little effort to influence public opinion against the government's socialist policies, the one exception to this being the small intellectual organisation Forum for Free Enterprise. Despite being an articulate voice for the private sector, it received little support from the business community and was opposed by the Federation of Indian Chambers of Commerce and Industry (FICCI), the leading Indian business association.

Throughout the 1950s and 1960s the FICCI avoided criticism of the government's development strategy. And even when industrial growth began to grind to a near halt in the 1970s, the FICCI's efforts to propose alternatives to government policies remained muted. The FICCI proved to be more concerned with protecting the interests of traditional industries such as textiles, jute and tea than becoming the voice of the entire business community.

In the absence of any coherent and powerful voice, individual firms made their own deals with government that in turn enabled the governing Congress party and its politicians to extract resources from the business sector for elections and for private gains. Many of the smaller firms and trading establishments, undercut by government financial institutions and by government efforts to control trade, became financial supporters of the opposition, a Hindu nationalist party whose militant Hinduism and anti-Muslim sentiment struck an emotional chord among the deeply religious members of the trading communities.

The Indian business community was divided not only on the question of how to deal with government, but also on the basis of caste, language, religion and region. There were separate associations of Bengali and Marwari businesses in Calcutta, differences between the Calcutta and Bombay business communities, and differences between Indian-owned and European-owned firms, all of which made any coherent policy on the part of business difficult.

Why was business unable or unwilling to use its financial clout – the power to invest or not to invest – to influence government policy? Why did the business sector not create an alliance with the agricultural sector, as it did in Japan and elsewhere to elect pro-business, pro-growth politicians? The explanations offered thus far – divisions within the business community by caste, ethnicity and region; popular antipathy toward middlemen; the reluctance to confront the nationalist hostility to capitalism – are only partial explanations.

By the end of the 1960s Indian business was in no position to call for a change in industrial policy, for by then few Indian firms were able to compete in the world economy under open market conditions. The import substitution policy led to the growth of inefficient companies, whose costs and prices were simply too high to allow them to compete globally.

Business was unable to use its financial power to withhold investment, elsewhere a powerful instrument for influencing policy-makers. International aid donors provided India with the foreign exchange the government needed to import capital goods for its public sector. By reducing pressures on the balance of payments, foreign assistance enabled the Indian government to maintain its policy of restricting foreign investment, and when foreign aid declined in the 1970s, India was able to obtain foreign exchange from the remittances sent by Indian workers in the Middle East.

The industrial policy changes introduced in 1991 by the prime minister were driven by the country's financial crisis, not by pressure from the business community or because the country's politicians, economists and bureaucrats had fundamentally rethought industrial development strategy.

expanding, government interventions that benefit that particular firm. Acting in its self-interest, each firm will press for expanding some interventions, although most will damage economic efficiency. While the owners and managers may favour less intervention as a principle, they will pursue this aim less passionately than interventions that benefit their firm directly and specifically. All of business, with each firm acting in its own interest, will then jointly be increasing government intervention. It is only by acting collectively, in their joint interest, that they will support reform, even though some parts of the reform package damage a particular firm.

- Some reforms, some aspects of reduced government intervention, actually harm the interests of more businesses than they help, at least in the short term. For instance, in many economies more firms produce for the domestic than for the world market. In such a situation, lower tariffs hurt the business community. It will therefore take *a statesmanlike, long-term view* for business to support lower tariffs. Yet tariff reductions may be essential to increase the efficiency of the economy. They will, therefore, in the long run, benefit the business community through more rapid growth and a more prosperous economy.
- Maintaining support for reform will usually require taxing the wealthy – particularly taxing, even restricting, some elements of their consumption. One reason would be to generate resources for measures to mitigate the negative effects of reforms on the most vulnerable groups. It would be in the interest of business to support this, to avoid a serious backlash that could abort reforms that are favourable to business in the long term.
- With a declining share of the economy under government management, and less control over the economy, there is a greater need for government to strengthen consumer protection. Business would normally resist most of these measures. But if they are not implemented, it will strengthen opposition to reform because its by-products include monopoly pricing by private firms, increased fraud and so on.

To make its most important contribution to a successful national development effort, business will have to act collectively, in the long-term interest of the business community and the economy, and accept some measures it dislikes in order to maintain widespread support for a more market-oriented strategy. Given the widespread conflict between the narrow interests of a particular enterprise and the broad interests of business as a whole, pressure from individual business may not effectively support reforms. Rather, the most effective and reliable support for reforms and for sensible policies will come from organised business groups.

If it is government policies that largely determine the rate of savings and investment, the efficiency of enterprises as a whole, the ability to sell into the world market and therefore to buy from the world market, and thus the rate of growth and the distribution of the benefits of development, then the influence of business on government policy is its most important contribution to economic development. The main point is that it is business's political role that is most important in determining the success or failure of economic development.

If the whole business community cannot or will not act to support reforms, because too many firms are concerned primarily with their own survival and short-term prosperity, then the reform effort will need to enlist part of business. Exporters and the more dynamic firms tend to be more supportive of reform. They get few benefits from the typical highly protective system, and can directly benefit from some reforms. Once the reform process is under way, if it is successful it will expand and strengthen its own constituency.

CONCLUDING REMARKS

Experience has shown that raising the income of the poorer 30–60 percent of the population requires the creation of productive employment for the unemployed, the underemployed, and unskilled additions to the labour force, which in developing countries is the great majority. This is probably the most important factor affecting political support for a development strategy, and the government that carries it out. The economic strategy adopted is crucial to the success of a development strategy. Only by acting collectively can the business community contribute to the adoption of an appropriate economic strategy. To act against immediate self-interest is never easy, but it may be feasible if it is done through a collective organisation of business, and business realises that the expected benefits are large. The benefits to business of successful development, in terms of growth and profits, would indeed be large.

Transitions to democracy in European history, and business's role

Michael O'Dowd

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There were no democracies before 1776. It follows that every country in the world that is a democracy today has undergone a transition from undemocratic to democratic rule. So, far from this being an extraordinary occurrence, as is often suggested in South Africa and in other countries that are undergoing such a transition, this must be regarded as a normal stage in the history of any country.

TRANSITIONS TO DEMOCRACY

Three kinds of undemocratic governments can be distinguished in Europe and North America in 1775, and we find three kinds of transition to democracy more or less corresponding with them in subsequent history. The easiest of these transitions is exemplified by the American colonies, where partially democratic assemblies already existed but were not sovereign. These assemblies asserted their independence in the Declaration of Independence of 1776, and it was by negotiation among the resulting 13 sovereign governments that the American Federation – the United States of America – was formed and the American constitution ratified. Other transitions to democracy along these lines later occurred in Canada, Australia and New Zealand, except that in those countries imperial power was withdrawn as a result of agreement and not of revolution. What is special about these transitions is that the institutions necessary for democratic government were already largely in place when the transitions took place, and the latter were essentially a matter of increasing the power and authority of those institutions. However, the American transition to democracy cannot be said to have been complete until 1964, when the last effective restrictions on the franchise of black people were removed. In total, the American transition to democracy in the full modern sense took just less than 200 years.

In Europe we can distinguish two roads to democracy, which tend to correspond to two types of pre-revolutionary governments – constitutional oligarchies, and autocracies. On the one hand, we have a process of successive reforms where an existing government extended the franchise in stages under the existing constitution, until full democracy was attained after a considerable period. The best-known example of this process, and on the largest scale, was that of Britain, but something similar to this also happened in Holland, Belgium, Sweden, Denmark and Switzerland.

On the other hand, there is the process of transition to democracy by revolution. By far the best-known example is that of France; others are Spain, Portugal and Italy. Rhetoric and mythology to the contrary, the record of revolutions in establishing democracy is not good. There have been more revolutions in European history that failed to establish democracy than those that succeeded in doing so, nor have those countries that followed the revolutionary path attained ultimate democracy faster than those that did not. By way of illustration, it is useful to consider the well-documented histories of Britain, France and Germany.

Britain

The transition to democracy in Britain occurred in four major steps, with more in between. The first major change took place in 1832, when the franchise was both extended and placed on a more uniform footing. Under the 1832 constitution, perhaps 20 percent of the male population had a vote, and the inequalities in the value of votes were greatly reduced, though they remained considerable. In 1867 the franchise was further extended so that somewhat more than half the male population had a vote, and at the same time the inequality in the value of votes was reduced to insignificance. This change took place under conditions of virtual consensus between the two political parties. The Liberals introduced a bill to extend the franchise, and the Conservatives immediately thereafter passed one that was considerably more far-reaching. The third major step took place in 1918, at the end of World War 1, in an atmosphere of social consensus. The franchise was extended to all men and some women, and by this time no important anomalies remained regarding the value of votes. The franchise was finally extended to all adults in 1929.

Where the activities of the business community can be detected, it is very rare indeed to find all of it on the same side.

It is a matter of opinion whether the 1832 franchise formed part of a transition to democracy. In a modern situation it would certainly be argued that, on the contrary, it was an attempt to save the oligarchy, and this is probably the light in which many of those who participated in it saw it. It is very possible that it was in fact a crucial step towards democracy, while it was intended to be quite the contrary. If we count the change in 1832, Britain's transition to democracy took almost exactly 100 years.

France

In 1788 France was an autocracy. Following the French Revolution the First Republic was established, based on universal male suffrage. While it lasted, this constituted the world's most complete democracy up to that time. However, it lasted a very short time. First, power was usurped from the elected assembly by the Committee of Public Safety, which exercised dictatorial power until the committee itself was overthrown. After a series of coups, the military dictatorship of Napoleon was finally established in 1802. This represents the first failed attempt to establish a democracy by revolution. In due course Napoleon was overthrown by his foreign enemies, and the French monarchy was restored, coupled with a parliament based on a very narrow franchise. This lasted only until 1830, when, in an almost bloodless coup, the king was replaced with another, and the constitution was changed, *inter alia* to extend the franchise significantly. The resulting 'monarchy of July' resembled the 1832 English constitution fairly closely. In 1848 the monarchy was overthrown in a major, violent revolution, resulting in the Second Republic based on universal male suffrage. The republic was overthrown within two years by a military coup, leading to the establishment of the so-called Second Empire under Napoleon III. While the empire's constitution was not democratic, it was validated by more than one referendum based on universal male suffrage. The genuineness of these referendums has been questioned.

Following the defeat by Germany in 1870 the Second Empire collapsed, and by general consent of all the political groupings, elections were held on the basis of universal male suffrage the following year. This led to the election of an extremely conservative assembly with a considerable majority of monarchists. The monarchists could not agree on who should be king, and the Third Republic was established as a reluctant compromise. Left-wing groups in Paris refused to accept the result of the election and attempted to overthrow the government by force, leading to the largest civil disturbance in the history of France, the outbreak known as the Paris Commune. This uprising was suppressed, and the Third Republic survived. In 19th-century terms, France was now a democracy. The vote was extended to all women in 1945.

The introduction of democracy here, as in Britain, took place in an atmosphere of widespread political consensus. We should not imagine that, after some unsuccessful attempts, France finally made the transition to democracy in one single leap. Rather, we should regard each of the constitutions, from the Restoration monarchy through the monarchy of July to the Second Empire, with its acknowledgement of the referendum, as steps in this direction. So the transition to democracy, in 19th-century terms, took some 80 years.

Germany

The case of Germany is complex, and includes elements of everything. Before 1848 all the major states of Germany were autocracies, while some of the free cities were oligarchic republics. There was a series of revolutions in 1848, aimed at establishing more or less democratic constitutions, but none of these was fully successful. Nevertheless, most of the states emerged after 1848 with constitutions of sorts, and with elected assemblies based on a restricted franchise. After the German Empire was established in 1870, the franchise, at least for imperial purposes, was extended to all males, but for the purpose of electing a parliament that was not sovereign. A great deal of power was reserved for the emperor, to whom alone the executive was responsible. In 1918, following the German defeat in World War 1, Germany became a republic, and the limitations on the power of the elected parliament were abolished. So, in 19th-century terms, Germany was a democracy. As we know only too well, this democracy did not last and gave way in 1933 to the dictatorship of Adolf Hitler. In 1948, when the independence of Germany was restored (at least in the west) by the conquering allies, West Germany became a full democracy with universal suffrage, and has remained one ever since.

Other countries in Europe

Some important events in other European countries need to be noted. In Russia in 1917, following a small-scale but nevertheless violent revolution, a provisional government was established and elections were called for a constituent assembly based on universal suffrage. When the outcome of the election became known, the Bolsheviks, who had failed to secure a majority, overthrew the provisional government by force, dispersed the constituent assembly, and established the communist dictatorship which lasted until 1992.

After an attempt to establish a democracy between 1931 and 1936 had ended in a major civil war, and a dictatorship, Spain made a smooth constitutional transition to democracy in 1976. Portugal is one of very few examples in Europe of democracy successfully established by revolution at the first attempt. In 1975 a violent but small-scale revolution overthrew the dictatorship of Dr Salazar, and after a period of relatively minor disorder a democracy was successfully established.

THE ROLE OF BUSINESS

It is rare to find business displaying a high profile in political events in the 19th century, and it is not always easy to discover what was going on behind the scenes; where the activities of the business community can be detected, it is very rare indeed to find all of it on the same side.

It is necessary to distinguish between the indirect consequences of the ordinary activities of the business community, and consciously concerted action undertaken to influence the political process. When looking at the latter in respect of business communities in Europe in the 19th century, the picture is complicated.

Business in the political process

In the early stages of democracy, the European business communities tended to align themselves with liberal parties whose agendas included demands for efficiency and rationality, opposition to established churches, opposition to class privilege, and strong (but not consistent) support for human rights. These business-orientated liberals were consistent enemies of slavery. However, the liberals were equivocal on democracy. When engaged in demanding political rights for themselves against feudal regimes, they often used quite extreme democratic rhetoric, but when they had secured power for themselves, or a share of power, their enthusiasm for more democracy was often less obvious. In Britain it was the Conservatives, not the Liberals, who extended the franchise significantly in 1867, although the Liberals had, in the previous year, proposed a less far-reaching extension. If the Conservatives' extension of the franchise was based on calculations of electoral advantage, then these calculations proved to be correct. During the 35 years of the 1832 franchise, the Conservatives were in power with a clear majority for only six. During the 51 years of the 1867 franchise, they were in power with a clear majority for half the time.

It is rare to find business displaying a high profile in political events in the 19th century, and it is not always easy to discover what was going on behind the scenes.

Although the historical link between business and the liberal parties was originally seen as very strong, as different issues arose in 19th-century politics the business community became more and more divided, and appeared on both sides of virtually all the big issues. Apart from democracy, the three great issues in 19th-century politics throughout Europe were free trade, imperialism and militarism.

- *Free trade:* This was regarded as one of the basic tenets of liberalism. In Britain, agitation against the

Corn Laws – ie, agricultural protection – in the 1840s was probably the most spectacular and unambiguous manifestation of political activity by the business community as a whole (or at least most of it).

Except in this case of the Corn Law, we find the business community divided on the issue of protection. This is hardly surprising; one cannot protect a whole economy. Protection increases prices, and these increases have to be paid by somebody. The clash of interests over protection is not between producers and consumers, or labour and capital, but between different sections of business, the interests of labour and capital within each section being the same. So, in France and again in Germany we find some businesses favouring protection, and others opposing it. When in England agitation for protection emerged again towards the end of the 19th century, businessmen were at the forefront of this movement, while businessmen were also in the forefront of the opposition to it.

- *Militarism*: After militarism became discredited by the two world wars, it became customary for the opponents of business to focus on the connection between business and militaristic regimes, as is exemplified by talk about the 'military-industrial complex' – indeed, they commonly alleged that the wars were brought about by business interests. However, in the time before World War 1, when militarism was extremely popular, especially among members of the working class, the accusation constantly levelled at business was that it was unpatriotic and undependable from a nationalist point of view because of its international ties. The favourite term of opprobrium used in this context was 'international capital'

Just as much as it creates friends in the business community, crony capitalism creates enemies. When favours are bestowed on some they are denied to others, and so the stronger the friends of the regime, the more bitter its enemies.

The fact is that there were elements of truth in both lines of attack on business. The military–industrial complex did exist, especially in Germany, but it did not involve the whole of industry; only particular and limited sections of it. The international ties and interests of business were also real, but again they were important to some businesses and not to others.

There are at least three reasons of self-interest why businesses that did not benefit from armaments should be opposed to militarism. Firstly, it is costly, and they would have to contribute to the costs. Secondly, militarism withdraws people from the labour market into the army, and has a tendency to raise wages. The third, however, is by far the most important and is the point on which the critics who talked about 'international capital' focused. Not only war but preparation for war and indeed the promotion of extreme nationalist sentiment in the population are bad for trade. This is the essential reason why militarists and extreme nationalists have always regarded business at large, as distinct from those particular sectors of business that are close to them, with suspicion and distaste. Napoleon's famous sneer at the British as a nation of shopkeepers illustrates this point.

- *Imperialism*: One of the most striking facts about 19th-century Europe is that in every successful imperialist country there was a strong, persistent and bitter anti-imperialist opposition. In Britain, opposition to imperialism was strongest in the small business sector, among people such as shopkeepers, although there were also large businesses that did not participate in imperialist trade. Liberals were also originally anti-imperialist, but once again the extent to which this reflected business interest varied.

There is one more phenomenon that has contributed to the confused and equivocal relationship between business communities and different political regimes. The relationship was also influenced by what has been referred to in recent times as 'crony capitalism'. This is the situation where a government, by means of elaborate, systematic and large-scale discrimination, confers major favours on particular businesses owned by people close to the regime, and enables these people to build large personal fortunes. However, the point that we must not lose sight of is that just as much as it creates friends in the business community, crony capitalism creates enemies. The essence of it is discrimination. When favours are bestowed on some they are denied to others, and so the stronger the friends of the regime, the more bitter its enemies. This describes the French Second Empire, which was at all times a controversial regime; strongly supported by some, hated by others, and with this division being found in all classes.

Given all these complications, it is not surprising that we do not find business playing a concerted and consistent role in the development of democracy in 19th-century Europe. Business could not intervene in the political process with any measure of unity or strength, and the relationship between business and the democratic transition tends to be confused and ambiguous. Businessmen have tended to act in their own self-interest, although we must not assume that 19th-century businessmen, any more than other people, were always motivated by considerations of self-interest. There are many examples of businessmen who took political positions contrary to their apparent interests, the most extreme example being Friedrich Engels, a friend and supporter of Karl Marx, who was himself a manufacturer.

Indirect consequences of business's activities

There are only two points on which we would expect, and indeed find, a certain degree of consistency.

Irrespective of their particular interests, all businesses fear disorder because they have assets to lose and disorder is bad for trade, so we would not expect to find the business community actively involved in promoting violent revolution. On the other hand, for precisely the same reasons, businessmen were often prominent in promoting reforms which they hoped or believed might lead to disorder being avoided. History tells us that democracy came about more often as a result of reform than revolution, and that revolution seldom produced democracy. So those who promoted reform in order to avoid revolution may have played a major role in bringing about democracy, even if they did not intend to do so.

The second point is that the same fear of disorder generally led the business community to uphold a democratic regime once it was in existence, provided it was able to deliver the basic requirements of government. The business community as a whole played a significant role in ensuring the survival of the French Third Republic. This is corroborated by the reputation that the Republic had at the time of being a businessmen's regime. Sometimes, its critics referred to it as 'the Rentier's Republic' Of course, a rentier is not a businessman – it is a person who holds government stock and lives on interest, but the relative orderliness and stability that served the interest of rentiers also served the interest of business, and also served to perpetuate France's first successful democracy.

In Europe democracy did not generally come about as a result of revolution, and even when it did, it was clearly only because other circumstances were favourable. For this reason, we have to take seriously the influence of activities that were not necessarily aimed at promoting democracy. One of these is education. In virtually all cases, the spread of education preceded rather than followed the establishment of democracy. From the earliest days in the 19th century, English factory owners made a practice of establishing schools for the children of employees, and one of the accusations brought against the factories by their Conservative critics was that they 'were educating working class children beyond their station'

History tells us that democracy come about more often as a result of reform than revolution, and that revolution seldom produced democracy.

This concept highlights one of the major issues involved in the transition from a feudal to a democratic society. In feudal societies, it was assumed that people were born on a particular level, where they were required to remain for the rest of their lives. The breakdown of those barriers and the promotion of social mobility was one of the major elements of the Liberal agenda, and on this issue, business was always on the Liberal side. Clearly, more was involved than just economic self-interest. It was related to a whole vision of life that grew out of trade and business, and was quite different from that fostered by a static agricultural society.

At the same time, employers had a clear and obvious motive of self-interest for opposing any rules that restricted their right to employ anyone in any capacity. There could be little doubt that the main purpose of educating the children of their factory workers was to ensure that they would have an adequate supply of people fitted for the more senior and responsible posts in their factories in the future.

It has been noted again and again, and is beyond dispute, that throughout modern history the transition to democracy has followed on a considerable period of economic development under capitalism. Until 1990 it was possible to say that no country had ever made a successful transition to democracy without also having undergone such development. In the light of the events of 1990 and subsequent years, this is no longer true. A number of countries that had undergone economic development under centralised socialism are now engaged in a simultaneous transition to democracy and to capitalism. It may be, therefore, that it is economic development as such, rather than economic development under capitalism, that is a necessary prerequisite for democracy. On the other hand, the historical link between capitalism and democracy has been strengthened by these events, since all the new democracies in central and eastern Europe are also engaged in a transition to capitalism.

Because business activity historically precedes the rise of democracy, it follows that capitalist business can and does coexist with undemocratic regimes. The symbiotic relationship between business and the government clearly existed in Europe, and business was able to co-exist not only with undemocratic regimes that were on the whole well disposed towards it, such as the French monarchy of July, or the British regime after 1832, but also with regimes distinctly unsympathetic to business, such as the British regime before 1832, the regime of the Tsars in Russia, or the Austrian Empire in the first half of the 19th century. The ability of capitalism to survive and operate in a hostile environment is one of its particular characteristics, and if, as the historical evidence suggests, it is a powerful agent for change, this ability is of the greatest importance.

Because business activity historically precedes the rise of democracy, it follows that capitalist business can and does coexist with undemocratic regimes.

CONCLUDING REMARKS

Political issues of the 19th century were divisive ones, and business rarely acted as a united and consistent body to promote democratic regimes. While none of these assertions are capable of proof, it seems likely, judging by the historical records, that the crucial role that business played in bringing about democracy in the long run consisted mostly in the breakdown of barriers to social mobility and the promotion of education. These were done partly out of self-interest, partly out of moral conviction, but a kind of moral conviction that grew in the *atmosphere of business* and generally not in the atmosphere of agriculture.

'Thickening' civil society: the impact of multinationals in China

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'Indochina, China, Russia: Despite the large volume of investment flowing in, these economies are not backed by a solid legal and conceptual framework. Multinationals should help to stimulate the creation of such networks.
Economist Intelligence Unit, Business Asia,
10 May 1993,

By accident of history, Hong Kong reverts to China in 1997 Hong Kong is the headquarters of the Asian offices of 670 multinationals, most of which are there because of the possibilities for entering China. As Hong Kong moves towards 1997 and Chinese sovereignty, it does so during a period of unprecedented growth. Although it will, to a degree, be sealed off under the 'one country – two systems' principle, it will nevertheless exert a great deal of influence over the modernisation of China. Above all else, it will be an example of a society with a dense and elaborate civil society, built under the strong influence of the interests of international business. China regards Hong Kong as a revolutionary cell, and the extreme resistance of Beijing to a voting constituency of even 20 percent of the population, and the reduction of the voting age from 21 to 18 (as in China), indicates the nervousness over democracy in the ultimate totalitarian state. This means that the penetration of civil society will be slow, and the responsibility for its encouragement will not be government's. It will be the private sec tor, especially multinationals, that will influence the building of civil society in China.

Much of the empirical information underpinning this study is drawn from the proceedings of a conference held in Beijing in September 1992, at which the State Commission for Restructuring the Economic System and the Stock Exchange of Hong Kong discussed the development of a 'healthy shareholding system' The speakers represented a large number of multinational merchant banks, accounting firms, lawyers, professional bodies and institutions. Their role was to make clear the conditions and processes involved in a modern financial market. The clear implication is a form of societal technology transfer that would eventually make the capital market system of China more complex, more sophisticated, more widely accessible, and probably very much more active. This in turn would sponsor related developments in professionalising, in education, and in the growth of supporting institutional structures. It is this 'thickening' which is the object of study.

BACKGROUND

China has always been a totalitarian state, and remains so. So far, the evidence is that the grip of the Communist Party on policy-making and on the military remains unyielding.

Having said this, it is possible to observe large-scale change taking place. Radical change is now occurring in China in the economic sphere, and it is clear that Deng Xiao-ping is driving this process. Further reforms are announced almost daily, and the attempt by Ju Rong-ji to pursue further growth while preventing overheating is beginning to seem successful. Since the 1979 change of policy, and the launching of Deng Xiao-ping's reforms, the pursuit of the 'socialist market economy' has led to the importing of a vast new array of ideas. Such ideas have commonly accompanied more tangible imports such as factories, managerial systems, joint venture agreements, products and capital, but the flood of ideas is leading to change. The change is commonly discussed in terms of the economic sphere: new forms of taxation, new commercial laws, new forms of ownership, and new processes of decision-making.

The making of a civil society, often over centuries, entails the construction, by freely co-operating individuals, of institutions situated between the individual and the state.

These quite remarkable experiments in compromise are being fostered without excessive concern over the paradoxes they entail. The economy is increasingly market-driven, but without many of the instruments of a market economy. Compromises derive from the unresolved dilemmas inherent in the attempt to modernise without political decentralisation.

The taking back of Hong Kong leaves two separate systems adjacent to each other. Control is being centralised and decentralised at the same time. Political ideology and economic ideology are in different compartments. The inherent contradictions of a 'socialist market economy' are being dealt with pragmatically and empirically as they are encountered; they have not yet led to any fundamental shift of ideological position.

CIVIL SOCIETY

In operational terms, the making of a civil society, often over centuries, entails the construction, by freely co-operating individuals, of institutions situated between the individual and the state. The institutions of civil society have the function of providing order and representing widespread interests of people who would otherwise be strangers. It is important to note that the family itself is not a component, and that the institutions in question are capable of posing, in fact are arguably designed to pose, an alternative locus of identity for the individual person. This is not to say that they are incompatible with the persistence of family loyalty. Rather, they weaken its monopoly.

An example of such an institution is a profession – let us say medicine, accountancy or engineering; equally so a trade union or trade association, or an environmental protection association that might put pressure on government. The function of such bodies is normally to produce order in a certain domain of social life. This is done through the establishment of regulations, and systems of self-government. Thus medical societies police the conduct and standards of their own members. Engineers covet membership of their societies, and conform professionally in consequence. Accountants govern their own conduct via auditing. Each provides stability and predictability of conduct in a particular field. The end result is a standardisation of behaviour that diminishes mistrust between strangers. This in turn fosters the growth of exchange between strangers. The intense kinds of growth typical of modern societies are then feasible.

It is regularly argued that China is a state without civil society, or at best only an embryonic form of it. If it is discernible in China, civil society of a kind conducive to intensive modern economic growth does not take a form recognisable under western assumptions of capitalism. Hence many scholars decry its weakness. Others argue more cautiously that western models are deceptive, and that China contains elements of the social structure needed to make a modern economy possible. This paper deals with one theme in the field of democratic transition, and because Chinese social structures cannot be demonstrated to be conducive to democracy, it will assume that *in that context* the sparseness or absence of what a westerner would see as the institutions of civil society is in fact the case. China is, in other words, in a pre-modern condition.

MODERNISATION

The great strength of Confucianism, and the reason why it has remained a legitimate and constantly reaffirmed ideology for so many centuries, is its use of the family as the centrepiece of its design for a stable society. It shows no sign of diminishing in relevance in China, despite having been forced underground as far as public discussion is concerned.

Capital market activities and their supporting civil society institutions

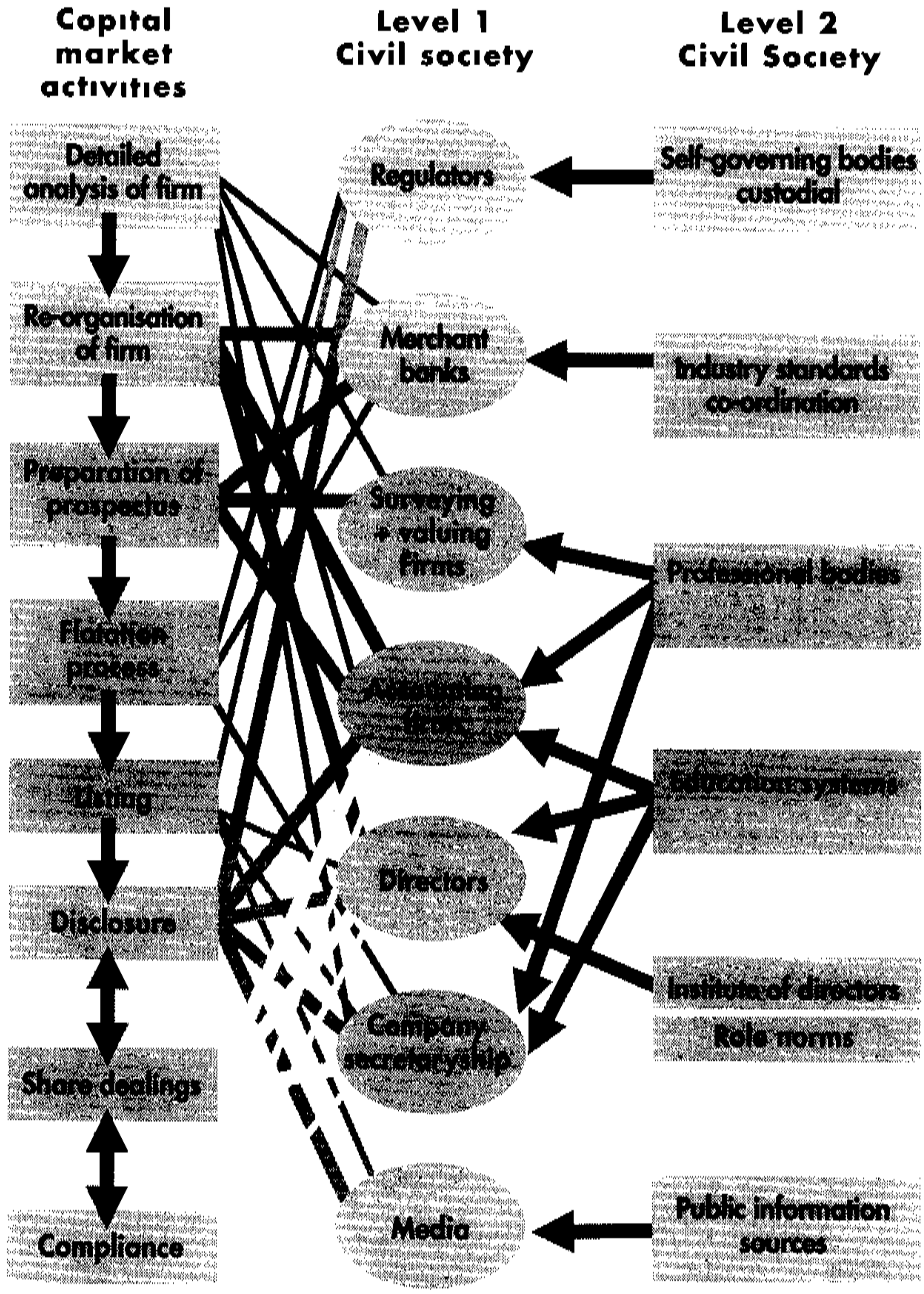

Figure 1

The expression in societal structures of the Confucian design for a stable state is an old model, and rests uneasily with the three main thrusts of modernisation: individualisation, specialisation and abstraction.

- *Individualisation* develops when the basic unit of society is taken to be the individual. This contrasts with the pre-modern peasant society, where the basic unit is the family, group, or community. The democratic vote, individually defined property rights, a legal system independent of government and qualifications through an open education system are all structures that foster this.
- *Specialisation* springs from the division of labour, and leads to a complex fragmenting of society. In parallel is a necessary process of integration via the spread of information, and the creation of means to sustain mutual trust. Civil society plays a crucial role here in providing trustworthy supports for integration, for instance a reliable system of accounting.
- *Abstraction* is the means of establishing widely accepted principles that foster such trust. Abstract principles are the alternative to depending on the authority of, say, a priest or a king, or, in the Chinese context, a mandarin or party official. Examples are the US constitution, Magna Carta, the Code Napoleon or a bill of rights.

The function of these instruments of modernisation is to foster two main processes: the stable decentralisation of decision-making power, and the encouragement of co-ordination. Fear of the disin-

BUSINESS AND CIVIL SOCIETY [5]

Through an examination of the role that international companies are playing in the process of economic change and modernisation in mainland China, the remarkable and profound effects of market processes on broader social structures are illustrated. The process of listing a firm on a public stock exchange, for example, requires a network of institutions, rules, monitoring processes, values and procedures that strongly influences the building of civil society.

Stages in the listing process

Detailed analysis of the firm

The first step in the listing process is an analysis of the firm to see if it is ready for listing. What this means, in effect, is that a body of institutions, specifically merchant banks, valuation firms and major accounting firms in effect sponsor it, and by implication confirm to the public that its management is professional, its internal systems rational, and its procedures conducted with propriety. This injects into the firm a set of standards, and their maintenance in the longer term remains an implicit responsibility of the same sponsors.

Reorganisation of the firm

This process involves mainly the directors of a given firm, as well as advice from merchant banks and accounting firms. Its main aim is to create clear units of organisation operating in business fields which the public can understand. It thus tends to move unrelated businesses into other capital-raising vehicles. It also attempts to deal with the problem of the power of minority interests to prevent a board from controlling a firm's behaviour. It also aims to clarify issues of prior borrowing, third-party relations and conflicts of interest.

In doing so, it might well advise a reconstitution of the board, and it may well also raise the consciousness of board members in respect of their statutory responsibilities.

Such a reorganisation of firms develops in response to public demand for such clarity. It thus responds to critical pressure from media commentary, financial analysts issuing advice from merchant banks, and a public informed by widespread access to information. Without these stimuli, the process in China will inevitably be embryonic.

Preparation of prospectus

The prospectus of a firm tells investors what the directors claim for its future, based on what the professional firms guarantee about its past. In Hong Kong the law imposes various criminal and civil liabilities to ensure that information is true and accurate. Directors, sponsors, underwriters, experts and professional advisers may be held personally liable for false or misleading statements. It is noteworthy that such liability is personal, and this demonstrates the working of the professional process in that the diffusion of responsibility for the public interest goes down to the individual level. In China the move of such responsibilities from the public sector to the private is only just beginning, but is now official doctrine. It is not clear how far it will be allowed to go.

Flotation

This is the act of placing shares on the market, and may be done in several ways, eg an offer of subscription, an offer of sale, an offer by tender, or placing. These vary by method chosen to reach investors, and also by method used to establish share prices, but they tegration of the Chinese state has led to an endemic concern with control, order and decentralisation. In consequence, attempts to move towards a more modern condition have been sporadic and, until very recently, objects of suspicion.

ORGANISING A CAPITAL MARKET

The position in China is that most business-related decisions remain heavily influenced by government agencies of one kind or another, and are thus inhibited. In the case of capital market formations, the supporting institutions are still vestigial, as are societal support mechanisms, such as education. The eventual effect of the penetration of multinationals will make the capital market system of China more complex, sophisticated and accessible.

In order to understand the way in which multinational corporations influence the building of civil society in China, it is necessary to focus on the processes and institutions that surround the discipline of making a company public, or 'listing' it. This act lies at the heart of the capitalist system; it is the means whereby a company is brought into the system of capital-raising so that the general public, and other bodies, can invest in shares in that company.

This is an elaborate procedure that requires back-up systems and structures in the fabric of society before it can work. Before the act is a set of activities, and after it another set. Each of these is fostered

are all conducted by professionals. Merchant banks, regulators and company secretaries are the main actors in the process. The use of media is also common in the marketing process. Again, some of the most critical activities, in addition to the mechanics, involve the application of professional judgment and especially the establishing of price, and that judgment is scrutinised in the interest of public good by the civil society bodies of the professions and the press. In China, these institutions are still to be built.

Listing

Listing is the sum of all the processes identified above, so will not be analysed as such.

Disclosure/share dealings/compliance

After going public, a firm enters into a new relationship with society, and the three related activities of disclosure, share dealings and compliance become matters of public interest. To guard that interest, sets of regulations are enforced by means of legal process and professional conduct. A critical aspect of this process is a judgment as to whether transactions are 'fair and reasonable', thereby seeking to protect the public interest.

Perhaps the most powerful civil society instrument serving to ensure compliance is a free press. Besides the press and its freedom is the question of publicly available data. In Hong Kong the volume and quality of this is high, and includes what is in public libraries, electronic data banks, the work of private sector analysts, and government data available via both publications and the records of the Companies Registry. China lacks such public data, and also lacks a free press. It also lacks independent professions. Effective disclosure and compliance still await the growth of such institutional supports.

So a successful listing requires the following to be in place, and working together in a complementary manner:

- stock exchange rules and procedures;
- a means of comparison with other firms through accepted criteria and processes;
- banking norms and standards;
- accounting firms;
- ways of training professional staff and monitoring implementation;
- company secretaries;
- a means of enforcement of these rules and standards; and
- media to inform the public that this has all been done to a satisfactory standard.

From this one example of a public listing, it is possible to generalise the kind of impact that multinational corporations are destined to have on a society such as China, and have already had on many other developing countries. It could be stated thus: a large multinational corporation needs certainty in order to invest; providing this certainty requires rules and standards; rules and standards require the means to create, monitor and maintain them; evolving, monitoring and maintaining rules and standards require institutions and associations; institutions and associations require independent individuals and evaluation; this in turn requires an independent judiciary, and information that is reliable and honest; and such information requires some form of open, free media and public debate.

Thus it can be argued that unintentionally normal business activity demands, requires and in turn creates a 'thickening web' of institutions, organisations, self-regulating mechanisms and professionals that comprise important components of civil society outside the state.

and supported by a set of institutions, as is the central act itself. *(See box)*

Figure 1 (see page 23) illustrates this by breaking down the listing process into components, and showing what institutions need to exist to support each component. It shows a set of eight activities analysable separately as components in the working of a capital market. Prior to a listing, the activities are one-off and sequential. After listing, the activities are more or less continuous and are interconnected.

The Level 1 civil society components are the institutions identifiable as being immediately involved in the listing process and its consequences. Supporting these are the more fundamental Level 2 components, particularly the support systems that supply predictable professional behaviour used at Level 1. Level 2 components are required to support the efficient working of Level 1 components.

The building of a civil society, or making an existing one more complete and more persuasive, serves to reduce personalism and enhance rationality and objectivity. Arguably, multinationals feel such needs more strongly or immediately than any other institutions.

The process of listing a firm on a public stock exchange requires a network of institutions, rules, monitoring processes, values and procedures that strongly influence the building of civil society.

Consistency with other more familiar systems of exchange is important as a means of reducing risk in decision-making. The bringing of order to a capital market, for instance, allows the market to be used like others. Without order the market is useless or very risky, and the natural tendency of the rationality-driven corporation such as a multinational, as its strives to expand its sphere of influence, is to attempt to impose its own form of order.

That it is multinationals in particular who carry such influences is attributable to two related and powerful needs: their need for *rationality* in the pursuit of consistency with their other operations, especially at the home base; and their need to cope with the high levels of uncertainty found in business environments such as China. In the wider context of a national environment, uncertainty is seen by most multinationals as a serious threat to the conduct of business. They cannot read the signals, they do not understand where the power lies, they do not understand the influence processes. Nor do they know the shape of the market, the appropriate cost structures, or the true nature of competition. To handle these, their collective wish is for information to be available, for qualifications to have meaning, for professional judgment and skill to be accessible, and for the governing regulations to be clear.

When looked at in terms of civil society, the influence process itself works firstly by promulgating standards, secondly by exemplifying the institutions that create and sustain such standards, and thirdly, at some remove, by creating a demand for the societal support structures that sustain the institutions. So access to capital requires listing; listing requires the skills of, among others, accountants; accountants require professional bodies; professional bodies requires accounting education.

What is now likely is that the privatisation of the economy, currently moving at a fast pace, and the extensions of commercial law will serve to reduce the grip of government. In turn, the need for alternative guarantors of order will stimulate the creation or enhancement of other societal institutions, such as professional bodies. If these take on their own momentum, then more basic support systems in education are predictable.

THE SIGNIFICANCE OF HONG KONG

Hong Kong has two main contributions to make to the modernisation of China, in the context of the business arena. The first is to provide an example of what traditional Chinese values can achieve, under encouraging conditions, with a traditional Chinese economic instrument – the family business. The second is to be a laboratory for the testing and possible adjustment of new institutions derived from the outside world.

The nature of China's transformation, and the state upon which Hong Kong's influence will play, is illustrated in figure 2 (see page 27). This takes as a starting point the three most significant underlying domains of cultural influence: the norms surrounding interpersonal trust, collectivist identity, and hierarchical authority. The historical and political circumstances are such that the transformation of China in the late 20th century takes place against the historical fact of late industrialisation and a political totalitarianism that has not yet been relinquished, although it is weakening under increasing regional pulls.

SOCIETAL TRANSFORMATION

The ideology legitimising the creation of new institutions

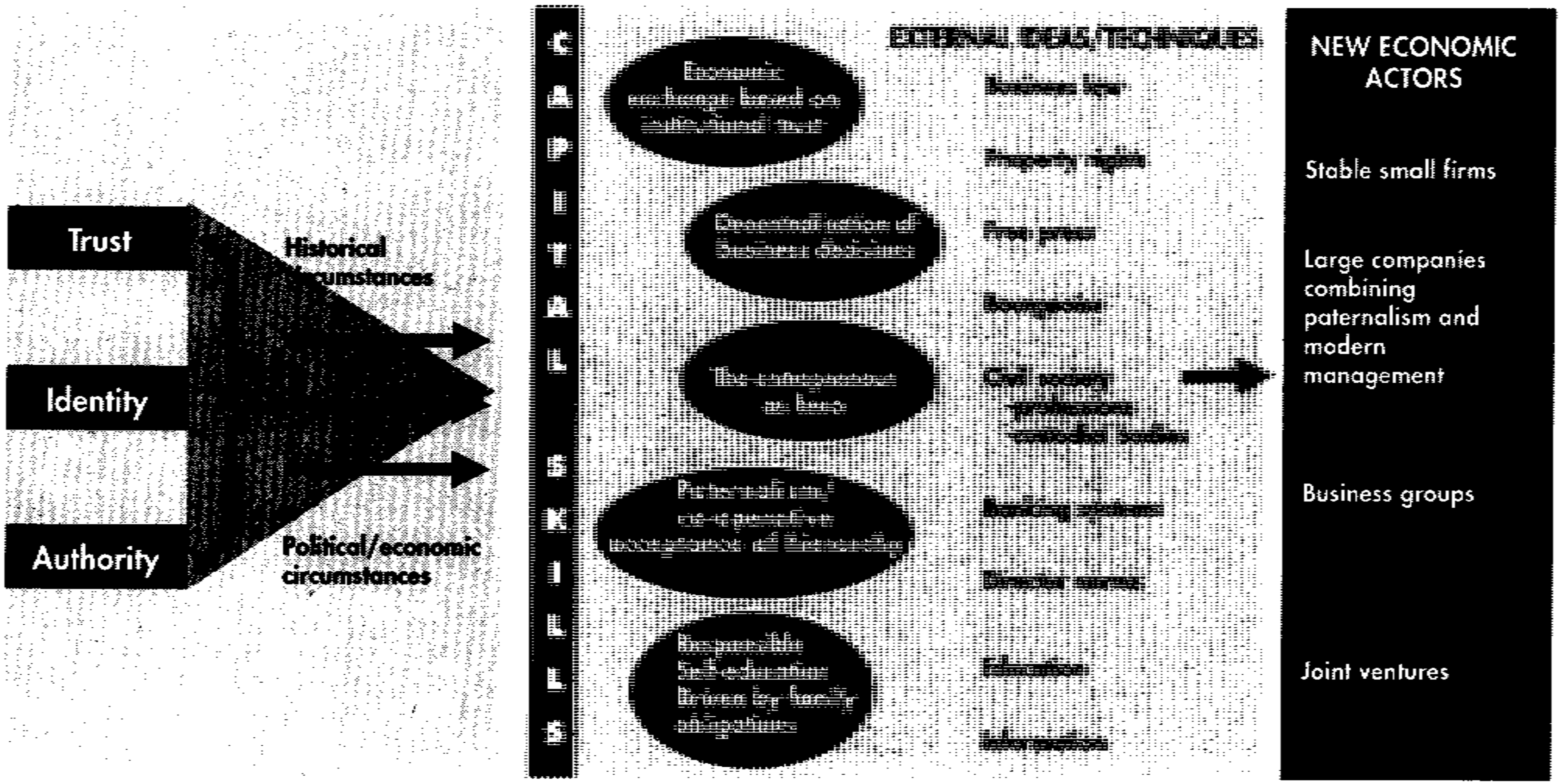

Figure 2

The transformation of societies as they industrialise and modernise is seen as working along two main dimensions: the reorganising of access to capital, and the reorganising of access to skills. Also identified are the institutions that are likely to be 'borrowed' from outside, and (as with similar historical borrowings into Japan) adapted and changed to fit local circumstances. The new economic actors are seen as outcomes, and are arguably visible now in China as growing favourites. Their eventual stabilisation will depend on this performance, and in turn on the interplay of many other factors, including world trends.

The significance of Hong Kong in the transformation process lies in its experience of how such structures can be made to work, and particularly the way in which it exemplifies the power of so much Chinese societal tradition adapting well to the modern context. Significant also is the 1997 transition to a situation where the learning is not from outside, but internal within China, a factor with substantial psychological influence.

CONCLUDING REMARKS

The process described in this paper is only one of many whereby the influence of multinationals is penetrating China. Other similar influences would be analysable in the fields of technology transfer, company management, training and education and commercial law.

It is likely that China will continue its process of pragmatically taking as much as it can accommodate, and at the same time absorbing an understanding of the complex whole, as well as the trade-offs involved in partial absorption. In some cases the barriers are ones of resources, as in the constraints on the educational system's ability to produce enough accountants. In other cases they are political, as the totalitarian tradition attempts to deal with the infiltration of free-standing institutions outside the political domain. What is clear is that multinationals will have a significant impact in 'thickening' what is currently a very thin substance.

Endnotes

1. A selection of these papers will be published in book form in 1997

2. These are partially democratic assemblies (which existed but were not sovereign, for example the American colonies); autocracies (where all governmental power and authority were vested in one person, sometimes subject to some legal restraints, more often theoretically subject to none – France, Germany, Italy, Spain, Portugal, Austria and Russia were all autocracies); and constitutional oligarchy (where government was elected, but by a minority, usually a small minority, of the population very often with votes of very unequal value. By far the most important country of this kind was Britain, where under constitutional monarchy the parliament was elected on a franchise that gave a vote of sorts to perhaps 3 percent of the male population. The votes were so unequal, however, that a majority of members of parliament were in fact appointed by a few hundred people.

3. Material in this box is extracted from a paper entitled 'Successful development and the role of business, written for this project by Prof Gus Papanek.

4. This box is an edited extract from a paper entitled 'Business in ethnically divided developing countries, written for this project by Prof Myron Weiner, department of political science, Massachusetts Institute of Technology.

5. This box is an edited extract from two papers written for this project by Prof Gordon Redding, entitled 'Capitalism and civil society in China and the role of Hong Kong and 'The impact of multinationals on the "thickening of civil society: current developments in the economy of China

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