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Globalization and democracy

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Keynes used to affirm that Montesquieu was definitively the best French economist. In the opposite side of Channel, this statement was considered as an additional provocation against France from the famous English economist. Perhaps Montesquieu does not hold in the economic thought the same place that in the field of political ideas. Other French economists as Quesnay, Cournot or Walras are more frequently quoted. However, in support to the Keynes's assertion, Montesquieu has approached a very contemporaneous question: the relationship between democracy and globalization. He wrote "*In a constrained nation, people work more to preserve than to acquire. In a free nation, people work more to acquire than to preserve*"¹. Free nations are more inclined to trade, inside and outside the borders. They protect safeness and property rights better than tyrannies. Montesquieu is even further when he distinguishes the luxury trade, which would be the fact of autocracies, and the "economic" trade assumed to be the practice of the "*government of several*"². The democratic nations would exchange more and the trade would be more gainful. Democratic nations would have a common interest to support peace. Indeed, a tyrant eventually might to give up his sumptuary purchases from an adverse country in the prospect that the war should increase its future consumption. At the opposite, a democratic nation will be reluctant to give up the "economic" imports of goods which are not produced inside. Peace will support the trade expansion because "soft manners" are a necessary and sufficient condition.³

This approach was since amended. Democracy and soft manners are no longer a necessary condition because trade impules itself an "endogenous" development of liberal and democratic institutions. In the 1970s, these doctrines were supported by many commentators as Samuel Pizar, a business lawyer, in the goal to justify the reinforcement of trade relations between the Western democracies and the totalitarian socialist dictatorships. Today, this point of view is always defended, as it was the case concerning the entry of China in the World Trade Organization. For the pros, it would be the best way to accelerate the process of democratization. The French journalist, Alexandre Adler thus declared few times ago: "Welcome to China. In Peking, the admission in the WTO takes the strategic figure of the

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¹ Montesquieu, *De.l' Esprit des Lois*, Livre XX, chapitre IV

² "*the trade has relationship with the constitution. In the government of only one, it is usually founded on the luxury, and though it is it also on the real needs, its principal object is to get for the nation which does it all that can be used for its pride, its delights and its imaginations. In the government of several, it is more often founded on the economy... Thus the republics of Tyr, of Carthage, of Athens, of Marseilles, of Florence, of Venice, and Holland, one makes the trade*"(Montesquieu, *De.l' Esprit of the laws*, Livre XX, chapter IV).

³ "*It is almost a general rule which everywhere where there are soft manners, there is trade; and that everywhere where there is trade, there are soft manners*"(Montesquieu, *De.l' Esprit of the laws*, Livre XX, chapter I).

victory of a world design based on freedom " . The European unification supports this thesis. The integration process is anchored to democratic values even in the countries with an authoritative or autocratic tradition. European Union encourages a country like Turkey to democratize its institutions. Extensively, the abolition of the child labor and trade-union freedom are spontaneously implemented with the development, which is itself accelerated by trade. Then, it would be counter-productive to slow down the trade with the "bad" countries. This endogenous development of democracy would lead to a convergence between the political and economic regimes. Few times after the attacks of September 11, Francis Fukuyama reaffirmed its prospect for the "end of history": "democracy and free trade will continue to extend with time as principles governing the organization of the world." ⁴

Globalization and democracy advances together. But, the most commonly quoted causality is from trade to soft manners. However, the recent literature gives some nuances. Two questions can be looked further into.

According to Montesquieu, the democracy appears as a necessary precondition to the development of the "economic" trade. We also saw that this precondition is no longer regarded as necessary because the trade instills the germs of democracy. The theoretical literature goes even further today: would the democracy be an obstacle to the trade openness?

We will show that facts justify the Montesquieu's point of view: countries with open trade policies are usually the most democratic. Nevertheless, the relation is dramatically complex. The semi-democratic countries sometimes trade less than the authoritarian ones.

The second question relates to the scope of democracy. Are we always in a democratic system if the choice of voters is extremely narrowed? The theoretical analysis confirms that reluctance to those possible effects of globalization.

Does the democracy support globalization? ⁵

There is no consensus about the nature of the relation between growth and democracy. Econometric studies achieve opposite and frequently weak evidences (Barro, 1996a & 1996b). However, Dani Rodrik (1997) shows that it is less risky to be democratic to obtain some "normal" long-run growth rate. Moreover, democracies produce greater stability in economic performances, handle better adverse shocks than autocracies, and pay higher wages (see also Rodrik, 1999). But if trade is an engine of growth, what can we tell about the specific relation between trade and democracy?

At a glance, the great democracies appear more open to trade but counter-examples can easily be found. Thus, the democratic institutions of India did not lead this country to open its economy more quickly than the Chinese dictatorship. It was during Pinochet's authoritarian government that Chile took the initiative of a trade and financial opening. During the 70s and 80s, Southern Asia registered the world's highest trade expansion under similar authoritarian regimes. China is now following the same path.

⁴ In *Le Monde* October 17, 2001

⁵ This part is mainly based on Granger & Siroën (2002).

The Chilean and Asian cases undoubtedly contributed to encourage a pessimist and revisionist point of view in the political economy literature. Democratic institutions became a possible obstacle to the economic opening. Democratic regimes would leave free course to the pressure of the protectionist lobbies (Olson, 1982) rents-seekers. Free riding is under a better control inside small groups than inside the large ones. So, a concentrated and organized industry has more chance to be rent-seeker than consumers. What politicians can lose in votes can be regained by the financial support of the protectionist organized groups (Magee, Brock & Young, 1989; Grossman & Helpman, 1994), or by the satisfaction of the median elector. Even if Taveres & Wacziarg (2001) show a slightly negative relation between the level of democracy and the degree of openness in their econometric study, these pessimistic theoretical approaches use very contestable assumptions and indicators. The general evolution towards free trade disqualifies the idea according to which the democratic countries are dominated by protectionist lobbies. Concentrated and organized industries are also present in the free-trading party. Export firms fear that protectionism drives to the closing of foreign markets and a lot of industries are interested by the import of low-priced inputs.

The "political market" alternative in the democracies is a greater corruption in the authoritarian countries. However, this link is not completely obvious: on the one hand, oligarchies make more difficult the installation of anti-corruptive and counter-power institutions, but, conversely, they have a larger authority to fight it. However, the enlightened tyrants are undoubtedly less frequent than the predatory ones. The empirical study of Wei (2000) highlights a negative (and weak) relation between democracy and corruption and between "natural" openness and corruption. However he cannot highlight a relation between corruption and trade policy. The explanation may be explained by the Montesquieu's intuition: the autocratic regimes do not prevent all kinds of imports but predict a trade oriented to sumptuary goods imports (including weapons). Democracies would prefer import "economic" goods contributing more positively to the national welfare.

Other authors renew the liberal tradition to underline the advantages of democratic regimes. An electoral regime neutralizes the capacity of big groups to be organized and reinforces the pro-trade consumers. In these circumstances, the median voter becomes favorable to the opening. On the contrary, the dictatorships are often dominated by small groups, which fear their revenues be threatened by the opening. The easier way to capture the power is to monopolize it.

Granger and Siroën (2001) explore the relation between democracy and openness and use the index of the *Freedom House*, a NGO ⁶ which incorporates various criteria to measure the degree of liberty (for example, free elections, existence of a representative opposition). They cross this indicator with the trade policy index proposed by Sachs & Warner (1995). The study confirms, with rare exceptions, that free-traders are also democratic. The great majority of the closed countries is among the least politically free. There are few democratic countries reluctant to free trade, India being the most important exception (see table 1).

In many countries, the political opening follows or precedes the trade opening. If we must be cautious about the causality, almost all countries opening their trade with an authoritarian

⁶ This index is available on: <http://www.freedomhouse.org/ratings/index.htm>. It is built starting from criteria concerned with the political rights (voting right, existence of an opposition, etc.) and of civil freedoms (freedom of expression, property right, etc).

regime have been also democratizing their political system. It is the case of countries like Taiwan or South Korea.

Table 1
The relation between the democracy and the commercial opening (78 countries)

	Free		Partially free		Nonfree
Opened (between brackets, year of opening)	<u>Argentina</u> (91), Barbados, Bolivia (86), Botswana (79), Costa Rica (87), Hungary (91), Israel (86), Jamaica (90), Maurice, Poland (91), Uruguay (91), Venezuela (90)	Benign (90), Brazil (91), Colombia (86), Cyprus, Ecuador (92), Honduras, The Philippines (89), Turkey (90)	South Africa (92), El Salvador, Gabon (86), Guyana (89), Indonesia (71), Malaysia, Mali (91), Morocco (85), Mexico (87), Nepal (92), Nicaragua (92), Paraguay (90), Peru (92), Sri Lanka (92), Thailand, Tunisia (89)	Jordan	Chile (76), Korea, Ghana (1986), Guinea, Guinea-Bissau (87), Taiwan
Closed	New Guinea, Trinidad and Tobago.	India	Bangladesh , Senegal, Sierra Leone, Zambia, Zimbabwe	Burkina Faso, Congo (Braz.), Egypt, Gabon, Kenya, Nigeria, Uganda, Pakistan	Algeria, Angola, Burundi, Cameroon, Chad, China, Congo (Zaire), Ethiopia, Iran, Iraq, Malawi, Mauritania, Mozambique, Niger, Rwanda, Somalia, Syria, Tanzania, Togo.

The "free" appreciations, "partially free", "non-free" are those of Freedom House. The position considered is the dominant one over the period and, if necessary, at the date of measurement of the liberalization. In the case of swinging around two positions, the country is ranked in an intermediate column.

The "opened" and "closed" indicators are taken from Sachs & Warner. A country is regarded as closed according to Sachs & Warner (1995) if it fills any of the five following criteria: (1) average rate of tariff higher than 40 %; (2) nontariff barriers covering more than 40 % of the imports; (3) socialist economic system; (4) State monopoly on main exports; (5) premium on the parallel market of the exchanges higher than 20 %.

The countries in heavy type know a democratic evolution. The underlined countries are those where the trade openness seems to be a consequence of democratization. The countries are in italics when the democracy has regressed, sometimes since the date of openness.

From Granger & Siroën (2001)

However, the Sachs & Warner indicator is subject to critics. It appears very severe with developing countries. Its success in the current economic literature is explained by the poverty of the alternative indicators of trade policy. In other respects, the trade openness is not only determined by the domestic trade policy but also by trade policies of foreign countries and by "natural" or "structural" features.

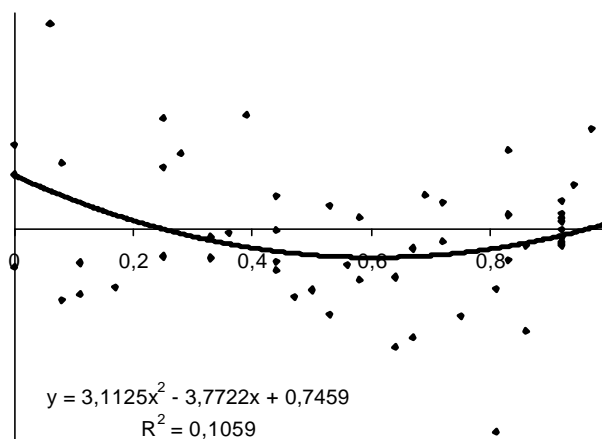
Granger and Siroën neutralize the "natural" or "structural" determinants of the openness as the size or the geographical insulation of the country which are not concerned by the political regime in the short run. Other factors can be indirectly related to the political regime like the level of development, but this relation concerns also the long run period. Finally some variables are more direct: trade policy which is not insensitive with the democracy like the environment of trade, freedom of communication, cost of transaction (including the cost of corruption), safeness of contracts.

The study by Granger & Siroën (2001) controls the "natural" determinants as the population, the transportation costs, proxied by the distance of the country with the first 15 bigger world markets, the degree of enclavement, measured by the extent of the territory relatively to the length of the coasts. The trade openness is measured by the ratio trade (imports+exports) on the PIB. The regression also includes trade policy indicators as the Sachs-Warner index, the level of tariff barriers, the free trade area membership. It also includes the level of GNP per capita as a development indicator. Lastly, the quantitative index of Freedom House is introduced into the equation with the risk of a relation between this index and the variables of trade policy and development.

The econometric analysis shows that the respect of the democracy exerts a direct influence on the volume of trade, which is independent not only from the "natural" factors but also from the choice of trade policy. But this relation has a U form (graph 1): all things being equal concerning the other variables. Openness decreases with a reinforcement of democracy from initial low levels. But, from a threshold, the relation between openness and democracy becomes positive. The minimum is reached for an indicator ranging between 0.45 and 0.6, which corresponds respectively to the level of democracy of Malaysia and Brazil (countries classified as partially free) . As it is always the case in this kind of regression, several countries move away from U what means that taking into account their level of democracy, they appear "abnormally" open (countries located above) or closed (countries located below).

Graph 1

Correlation between the trade openness (y-axis) and the index of democracy (x-axis) the other determinants being considered



From Granger & Siroën (2001)

The U-form can be explained by a minimum degree of maturity of democracy which would be necessary to escape to the prevalence of special interest groups and more generally to the political instability and the weakness of the institutions charged to fight against corruption and to impose the respect of the rule of law. This convex curve could also confirm the Montesquieu's prediction according to the idea that openness would drive to substitute the democratic "economic" trade for the autocratic luxury trade.

At this step of the analysis one can thus conclude that democracy and trade openness go hand in hand with few exceptions,. But the empirical evidences show that the relation is not simple.

Indeed, democratization can act negatively and counter the effects of trade liberalization frequently associated with democratization. It is only for countries having reached an intermediate level of democracy that a positive direct relation can be highlighted.

Does globalization reduce the scope of democracy?

The indicator of democracy we used applies to the formal exercise of democracy and relates to criteria of civil freedoms and elective legitimacy of the political leaders. But they do not take into account the extent of the choices suggested to the citizens. Up to what point does the globalization reduce the range of the political choices?

The analysis can be founded on the stylized figure proposed by Dani Rodrik (2000)^o and similar to the Mundell's incompatibility triangle, which is well-known among the economic policy specialists. The three vertices of the triangle are global integration, sovereignty of the Nation-States which confers the capacity to make the national law and to manage it, political participation (mass politics) which implies a high degree of political mobilization. Similarly to the Mundell's trilemma, only two among these three criteria can be simultaneously respected.

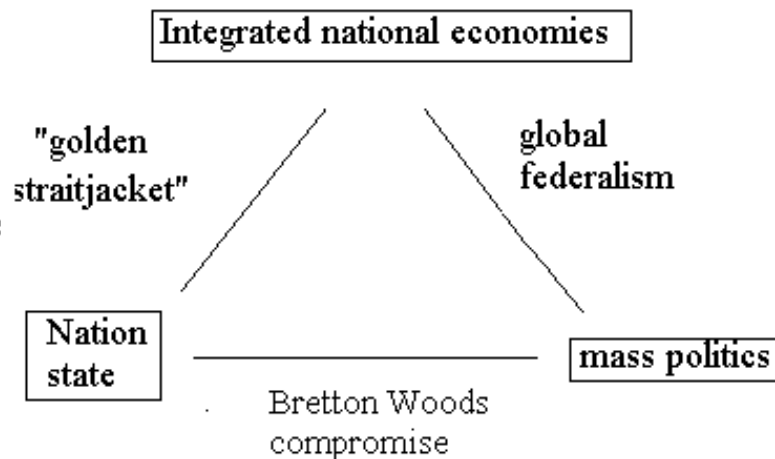
The post-World War II international order - the Bretton Woods deal - affirms a strong respect of the "Nation State " and "political Participation" criteria. The countries preserved a large autonomy concerning market regulation, fiscal policy, industrial policy, and the nature of the welfare-state system. The diversity of Western "models" (Japanese, Swedish, Rhineland model,.) shows that citizens could affirm specific preferences. They were lightly forced by requirements of competitiveness. Moreover, States preserved possibilities to restrict integration and to segment the markets. They effectively imposed controls to the mobility of capital and protectionist policies in agriculture, steel or textile industries. In the years 1970 and 1980, this configuration was called into question. The crisis of the international organizations -IMF, WTO - which were built on the "Bretton Woods" doctrine, can be understood as the consequence of the reinforcement of the "globalization" vertex, which necessarily weakens at least another one.

A possible scenario links integration to political participation. These two criteria are compatible in a system of "world" or global federalism, which would reproduce at the world level some American-style federalism or the kind of integration modeled by the European unification process (despite of the lack of democracy in the European institutions). The political participation would be expressed at an upper level. This scenario implies an institutional convergence, which should go until common and universal laws and world jurisdictions and standards. They would be adapted to integrated markets. It is a scenario of "world" or "global" governance

A second scenario closely associates the States-Nations and the world integration under the metaphoric denomination of "golden strait-jacket" given by the American journalist Thomas Friedman. The national sovereignty is exerted at the level of the government, but only to support the competitiveness of the domestic firms on integrated markets. States must lead policies in compliance with the expectations of the market, to propose an attractive taxation for the direct investments and a loose social legislation. As Thomas Friedman (1999, pp. 87) points out: "once your country puts on the Golden Straitjacket, its political choices get reduced to Pepsi or Coke". This option is not compatible with the "political participation" which could reveal objectives incoherent with the constraint of competitiveness. The

multiplication of independent agencies, like the central banks, the recourse to international organizations contribute to shelter a part of the public decisions from democratic control. According to Thomas Friedman, this evolution is rather desirable because it releases the individuals of the influence of a State necessarily bureaucratic and inefficient. New technologies associated with the globalization ensure a greater autonomy to citizens what would be enough to reinforce individual freedoms.

Graph 2 The Rodrik's Trilemma



To illustrate this trilemma, let us take the example of the taxation. This choice does not concern only a convenience. The oldest democracies, and especially the French one, have been born from the will of citizens to control their taxation regime and to take care of the republican principle of equality face to the tax burden. In a Bretton Woods regime, States may largely arbitrate between the type of taxation. If the taxation on saving is too heavy, the outflows of capital will have to be repressed. Financial integration -the globalization- make these controls impossible and full fiscal choices are incompatible with the couple State-Nation/ political participation. If we consider the integration as a "hard" constraint, we can only arbitrate between the "golden straitjacket" and the "world federalism". ..

Does the globalization really deprive the citizens of sovereignty as regards taxation? Even if the tax systems remain disparate between countries, the answer is rather positive. If a country increases its taxation based on saving, the tax basis will move towards the most fiscal competitive countries, particularly since the globalization tends to reduce the costs of transaction. Then, the globalization creates a vicious circle, the famous race to the bottom process, which is a particular expression of a prisoner's dilemma. Even if only few countries seek to benefit from the globalization to reduce their taxation and thus to attract the financial saving, the other countries will have no other choice to adopt the lowest taxation to stop the fiscal evasion. In a more general way, the globalization will make more difficult to tax the mobile factors: financial, highly qualified labor. It will result an extra burden against the least mobile factors like unqualified labor or land capital. The consequence could be a rise in the labor cost, which will result either in unemployment, or in the contraction of the income distributed to them with increasing inequalities as a result. More unequal the country is, more

the majority aspires to some redistributive taxation and more the globalization is opposed to this will.

However, the risk should not be exaggerated. Public expenditures are still increasing in the industrial countries. Rodrik (1998) has pointed out that the most open countries are also the countries where the share of the public expenditure in the GNP is the highest. Concerning the "race to the bottom" effect, the French municipalities keep very disparate local taxations, which appear sustainable even if the lack of equity between the "rich" and the "poor" municipalities is frequently denounced. Indeed, the expatriation is costly. But, even if the trend is soft, the risk is real along the deepening of a globalization process.

What we have just described is a scenario where the globalization would be associated to a Nation-state exerting its coercive power as regards taxation. But this kind of State has only few options like the variations of some points of VAT rates. The scope of the choices depends of the advancement of the globalization process. If the ability to choose is exerted, it can lead to an unsustainable loss of competitiveness or to an evasion of mobile factors.

Is the globalization compatible with the political freedom to choose as regards of taxation, what means the world federalism under the trilemma scheme? Without going so far as a world Parliament with members elected by the world citizens, this federalism might start with the reinforcement of the co-operation between legitimate democratic governments to edict common rules. Concerning specifically the fiscal "dumping", these rules should fix minimum rate of taxation on the saving or the principle of taxation in the country of origin with a cooperation between the fiscal authorities. These rules would be effective only if sanctions balance the gains of defection. But this international economic law would be incompatible with the full sovereignty of States as the trilemma predicts it.

The prospect for a world tax federalism is obviously rather remote. If the process of European unification is regarded as a geographic limited experiment of world federalism, the assessment is not very conclusive. One among the great failures of the Single market was its incapacity to impose a significant tax harmonization.

These difficulties are not surprising. An integrating world is a world aggregating heterogeneities before erasing them in the uniformity (Siroën, 2002). The globalization increasingly makes perceived the exercise of democracy as the dictatorship of a majority against distant minorities. The challenge of the globalization thus reformulates the traditional interrogations on the "fairness" of democracy.

Conclusion

The connections between globalization and democracy are contradictory. At the first glance, trade openness supports the installation of institutions based on free elections and civil rights. At the second glance, globalization reduces the scope of political choices.

The influence of the globalization on the democratic choices constitutes a real danger, which is only partially covered by the actual system of international relations. If taxation has been taken as an example, the conclusions could be carried out as regards environment, labour, corruption and competition.

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