

Amy L. CHUA

THE PARADOX OF FREE MARKET DEMOCRACY IN THE DEVELOPING WORLD

Amy L. Chua is Professor of Law at Duke University, and currently a visiting professor at Stanford University. She received her J.D. from Harvard in 1987 where she was the Executive editor of the Harvard Law Review. She clerked for Chief Judge Patricia Wald of the U.S. Court of Appeals (D.C. Circuit, 1987-1988), and was an Associate with Cleary, Gottlieb, Steen & Hamilton from 1988-94, where she worked on numerous international transactions in Asia and Latin America, including privatization of Telefonos de Mexico. She joined the Duke faculty in 1994. Professor Chua is currently a member of the Executive Committee and Executive Council of the American Society of International Law, and her publications include "Markets, Democracy, and Ethnicity: Toward a New Paradigm for Law and Development" (Yale Law Journal) and "The Privatization-Nationalization Cycle: The Link Between Markets and Ethnicity in Developing Countries" (Columbia Law Review). Her principal areas of interest are law and development, comparative law, international business transactions, and contracts.

The Paradox of Free Market Democracy: Rethinking Development Policy

Amy L. Chua^{*}

Markets and democracy are “the twin pillars” of prevailing development orthodoxy.¹ Many have explored the ways – “theoretical, historical, and empirical” – in which these two pillars are said to reinforce each other.² By contrast, this Article will focus on an inherent *instability* in free market democracy.

For a long time, leading political philosophers and economists held that market capitalism and democracy could coexist, if at all, only in fundamental tension with one another.³ Markets would produce enormous concentrations of wealth in the hands of a few, while democracy, by empowering the poor majority, would inevitably lead to convulsive acts of expropriation and confiscation. In Adam Smith’s words, “For one very rich man, there must be at least five hundred poor The affluence of the rich excites the indignation of the poor, who

¹ Professor of Law, Duke University. For their helpful comments, I would like to thank Bruce Ackerman, Owen Fiss, Gerry Gunther, Henry Hansmann, Tom Heller, Donald Horowitz, Mark Kelman, Gerald Neuman, Jed Rubinfeld and the participants in workshops at the University of Chicago and Columbia University.

² Jagdish Bhagwati, *Democracy and Development: New Thinking on an Old Question* 29-32 (1995); see LESTER C. THURLOW, *THE FUTURE OF CAPITALISM* 1-5 (1996); ROBERTO MANGABEIRA UNGER, *DEMOCRACY REALIZED* 3 (1998). I have described elsewhere the recent explosion of interdisciplinary work on marketization and democratization in the developing world. See Amy L. Chua, *Markets, Democracy, and Ethnicity: Toward a New Paradigm for Law and Development*, 108 *YALE L.J.* 1, 14-19 (1998).

³ Larry Diamond, *Democracy and Economic Reform: Tensions, Compatibilities, and Strategies for Reconciliation*, in *ECONOMIC TRANSITION IN EASTERN EUROPE AND RUSSIA: REALITIES OF REFORM* 107, 108 (Edward P. Lazear ed. 1995); see, e.g., PETER BERGER, *THE CAPITALIST REVOLUTION* 73 (1986) (describing the contemporaneous rise of capitalism and democracy in Europe and the United States); ROBERT DAHL, *ON DEMOCRACY* 168 (1998) (suggesting that market-capitalism “creates a large middling stratum of property owners” who “are the natural allies of democratic ideas and institutions”); Diamond, *supra*, at 108 (observing that both capitalism and democracy rest on “fundamental principles of competition and choice” and are threatened by “excessive concentration of power in the state”); Owen M. Fiss, *Capitalism and Democracy* 13 *MICH. J. INT’L L.* 908, 911 (1992) (“Both notions are rooted in assumption of human rationality and self-interest, and thus rely on individual freedom and autonomy as the means for achieving their ends”).

⁴ See, e.g., JAMES MADISON, *NOTES OF DEBATES IN THE FEDERAL CONVENTION OF 1787*, at 403-4 (1976); THOMAS BABINGTON MACAULAY, *COMPLETE WRITINGS*, vol. 17, at 263-76 (1900); *THE WORKS AND CORRESPONDENCE OF DAVID RICARDO* vol. 7, at 369-70 (Peiro Sraffa ed. 1973); KARL MARX, *THE CLASS STRUGGLES IN FRANCE (1848-50)*, at 69-70 (New York: International Publishers 1934); see generally STEFAN COLLINI, DONALD WINCH & JOHN BURROW, *THAT NOBLE SCIENCE OF POLITICS: A STUDY IN NINETEENTH CENTURY INTELLECTUAL HISTORY* 102-7 (1983); ROBERT A. DAHL, *A PREFACE TO ECONOMIC DEMOCRACY* 2, 62-73 (1985).

are often both driven by want, and prompted by envy, to invade his possessions.”⁵ Madison warned against the “danger” to the rights of property posed by “an equality & universality of suffrage, vesting complete power over property in hands without a share in it.”⁶ David Ricardo was willing to extend suffrage only “to that part of [the people] which cannot be supposed to have an interest in overturning the right of property.”⁷ Thomas Babington Macaulay went further, portraying universal suffrage as “incompatible with property” and “consequently incompatible with civilization.”⁸ From this point of view, free market democracy is a paradox, a contradiction in terms.

But as it turned out, the Paradox of Free Market Democracy did not prove insuperable. On the contrary, while “[d]emocracy and market-capitalism are locked in a persistent conflict,”⁹

⁵ ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* bk. V, ch. I, pt. II, at 232 (1776) (Chicago ed. 1976). In a more contemporary vocabulary, the “equality of franchise in a democratic society creates a tendency for government action to equalize incomes by redistributing them from a few wealthy persons to many less wealthy ones.” ANTHONY DOWNS, *AN ECONOMIC THEORY OF DEMOCRACY* 198 (1957).

⁶ James Madison, *Note to His Speech on the Right of Suffrage* (1821), in 3 *THE RECORDS OF THE FEDERAL CONVENTION OF 1787*, at 450, 452 (Max Farrand ed., 1966).

⁷ *THE WORKS AND CORRESPONDENCE OF DAVID RICARDO*, supra note ___, at 369-70.

⁸ MACAULAY, supra note ___, at 268.

I am far from wishing to throw any blame on the ignorant crowds . . . We ourselves, with all the advantages of education, are often very credulous, very impatient, very short-sighted, when we are tried by pecuniary distress or bodily pain. . . . Imagine a well-meaning laborious mechanic fondly attached to his wife and children. Bad times come. He sees his wife whom he loves grow thinner and paler every day. His little ones cry for bread; and he has none to give them. Then come the professional agitators, the tempters, and tell him that there is enough for everybody, and that he has too little only because landed gentlemen, fundholders, bankers, manufacturers, railway proprietors, shopkeepers, have too much? Is it strange that the poor man should be deluded, and should eagerly sign such a petition as this? The inequality with which wealth is distributed forces itself on everybody’s notice. It is at once perceived by the eye. The reasons which irrefragably prove this inequality to be necessary to the well-being of all classes are not equally obvious. . . .

. . . And do you believe that as soon as you give the workingmen absolute and irresistible power they will forget all this? . . . In every constituent body capital will be placed at the feet of labor; knowledge will be borne down by ignorance; and is it possible to doubt what the result must be? . . . What could follow but one vast spoliation? One vast spoliation!

Id. at 271-72, 274.

⁹ DAHL, supra note 2, at 173. As Dahl has noted, this conflict “can be understood in two ways: Democracy may be seen as a danger to property rights; or property rights may be seen as a danger to

this conflict has been more or less successfully negotiated throughout the developed world. Defining the terms broadly, markets and democracy have coexisted quite healthily in the United States for two hundred years, and at least a dozen other developed countries “have remained continuously capitalist and democratic for the past half-century.”¹⁰ That democratic politics proved compatible with capitalism in the First World -- that the electoral “power of numbers” did not overwhelm the “economic power of property”¹¹ -- is one of the great surprises of modern history.¹²

Will the Paradox of Free Market Democracy be similarly negotiable in developing societies? Through what institutions? What face will the Paradox assume in the developing world? Law and development, booming anew today,¹³ has systematically ignored this set of questions -- a remarkable omission, given the confidence with which democracy and markets are being exported all over the Third and postcommunist worlds.¹⁴

democracy.” DAHL, *supra* note __, at 68. On the first view, the concern is that “[a] majority made up of the less prosperous will be able to use their equality in the state to appropriate the property of the wealthier minority.” *Id.* On the second view, the danger is that “a minority of rich will possess so much greater political resources than other citizens that they will control the state, dominate the majority of citizens, and empty the democratic process of all content.” *Id.*

¹⁰ Adam Przeworski, *The Neoliberal Fallacy*, in CAPITALISM, SOCIALISM, AND DEMOCRACY REVISITED 47 (Larry Diamond & Marc F. Plattner eds., 1993).

¹¹ Claus Offe, *Democracy Against the Welfare State?*, in MODERNITY AND THE STATE 147, 154 (1996).

¹² For a particularly interesting discussion of the “peaceful” but “precarious” “coexistence between democracy and capitalism” in industrialized Western societies, see JÜRGEN HABERMAS, *The New Obscurity: The Crisis of the Welfare State and the Exhaustion of Utopian Energies*, in THE NEW CONSERVATISM 55-56 (1985); see also DAHL, *supra* note __, at 166-79 (describing the “antagonistic symbiosis” between democracy and market-capitalism); CHARLES E. LINDBLOM, POLITICS AND MARKETS 159, 161 (exploring “the close but uneasy relationship between private enterprise and democracy”). For economic models exploring the same phenomenon, see JAMES M. BUCHANAN, THE LIMITS OF LIBERTY: BETWEEN ANARCHY AND LEVIATHAN 147-65 (1975); DOWNS, *supra* note __, at 198; Allan H. Meltzer & Scott F. Richard, *A Rational Theory of the Size of Government*, 89 J. POL. ECON. 914, 916 (1981); Sam Peltzman, *The Growth of Government*, 23 J. L. & ECON. 209, 222-23 (1980).

¹³ See generally Chua, *supra* note __, at 8-21 (describing the new law and development movement and comparing it to the law and development movement of the 1960s and 1970s); John H. Merryman, *Comparative Law and Social Change: On Origins, Style, Decline & Revival of the Law and Development Movement*, 25 AM. J. COMP. L. 457, 472-83 (1977) (describing and critiquing the earlier movement).

¹⁴ The self-confidence characteristic of today’s law reform efforts in the developing world contrasts jarringly with the self-questioning (and in some cases self-flagellation) that accompanied the decline of the earlier law and development movement, the basic thrust of which was also to export democratic capitalism to the developing world. See, e.g., David M. Trubek & Marc Galanter, *Scholars in Self-Estrangement: Some Reflections on the Crisis in Law and Development Studies in the United States*, 1974 WIS. L. REV. 1062, 1070, 1080. As a number of commentators have suggested, the angst about “cultural imperialism” in the 1960s and 1970s was in significant part a product of the Vietnam War. See, e.g., Richard Bilder & Brian Z. Tamanaha, *The Lessons of Law-and-Development Studies*, 89 AM. J. INT’L L. 470 (1995). Similarly, the absence of self-doubt today probably reflects the collapse of the former Soviet Union and the sense (at least in the West) that there is no acceptable alternative to the Western developmental paradigm.

This Article makes four points. The first, in the nature of a hypothesis that I will try to make plausible but will not be able to prove, is that the Paradox of Free Market Democracy in the developed world is and always has been mediated by a host of devices substantially de-escalating the conflict between market-generated wealth disparities and majoritarian politics. These devices, while varying widely across nations, generally fall into three categories: material, political, and ideological.

Materially, in all the developed nations, the less well-off have essentially been “bought out,” in part through market-generated material prosperity, but also in significant part through strong networks of redistributive institutions.¹⁵ Politically, in addition to a long history of massive exclusions from the suffrage, Western nations have a variety of institutions that restrain majoritarian confiscatory impulses, including separation of powers and constitutional property protections.¹⁶ Finally, these “buy-outs” and political restraints have been supplemented, perhaps crucially, by the existence of various *market-compatible ideologies* – belief-systems that make the less well-off majority more inclined to accept or at least not to rebel against the extreme income disparities produced in a market economy. Probably the most prominent of these ideologies in the United States is that of upward mobility.¹⁷

(To avoid misunderstanding, I am not concerned with the *origins* of these mediating institutions and ideologies. For example, I am not making the functionalist claim that market-compatible ideologies emerged in the developed nations because the Paradox of Free Market Democracy “demanded” them. My concern, rather, is with *effects* – in particular, with the neutralizing impact that these institutions and ideologies have had on the conflict between markets and majoritarian politics.)

Second, these developed-world mediating devices are largely absent from the developing world, and there is no reason to assume that they will be spontaneously generated by market and democratic reforms. On the other hand, many developing countries *do* have one highly effective restraint on democracy: systemic political corruption. In recent years, anti-corruption initiatives have become a major thrust of international development policy. These initiatives are long overdue and of the utmost importance, but to the extent that they succeed, they will sharpen the conflict between markets and democracy.¹⁸

Third, in critical respects, the Paradox of Free Market Democracy is much more dangerous and potentially explosive in the developing world. To begin with, in terms of sheer numbers, the poor are vastly more numerous, and poverty far more entrenched, in the developing world today than in the developed world, either today or at analogous historical periods.¹⁹ In

¹⁵ See *infra* TAN __.

¹⁶ See *infra* TAN __.

¹⁷ See *infra* TAN __.

¹⁸ See *infra* TAN __.

¹⁹ See *infra* TAN __.

addition, universal suffrage is generally being implemented in the developing world on a rapid, large-scale basis that contrasts sharply with the very gradual and incremental enfranchisement characteristic of the history of Western democratization.²⁰ Moreover, perhaps most fundamentally, in stark contrast to both the Western nations and all the East Asian “Tigers,” many developing countries have one or more ethnic minorities who, along with foreign investors, will tend under market conditions to economically dominate the “indigenous” majorities around them, at least in the near to midterm future.²¹ The existence of such *market-dominant* minorities, together with other conditions prevalent throughout the developing world, converts the Paradox of Free Market Democracy into an engine of potentially catastrophic ethnonationalism. In these circumstances, democracy will often mobilize majoritarian ethnoeconomic resentment into powerful nationalist movements potentially subversive of both markets and democracy themselves.²²

Thus, the Paradox of Free Market Democracy often has an entirely different face in the developing world. The ethnic and racialist structures of the developed world typically help *defuse* the conflict between markets and democracy, essentially by fracturing the poor majority. In the United States, for example, racism (together with a thriving ideology of upward mobility) arguably makes poor and lower middle class whites feel more “kinship” with wealthy whites than with African-Americans or Hispanic-Americans of comparable economic status. As a result, racism in the United States creates no particular threat to a market economy. On the contrary, to the extent that racism helps reconcile a great number of poor and working class whites to the prevailing economic hierarchy (because there is a group still lower than they) and impedes political coalitions among the poor, racism helps to mediate the Paradox of Free Market Democracy.²³

By contrast, the distinctive overlapping of class and ethnicity characteristic of many developing countries -- in which the “very rich” are (or are perceived as) ethnically distinct -- tends to *catalyze* the Paradox of Free Market Democracy, with democracy pitting an “indigenous” majority against an economically dominant “outsider” minority.²⁴ This dynamic is not a mere theoretical possibility in the developing world. It is a persistent, lethal reality, as recent events in Indonesia have once again illustrated.²⁵

Finally, for all these reasons, it is irresponsible to promote markets and democracy in the developing world in the absence of institutions capable of mediating the conflict between them. To be sure, today’s prevailing policy approach to law and development does include proposals

²⁰ See *infra* TAN __.

²¹ See *infra* TAN __.

²² See *infra* TAN __.

²³ See *infra* TAN __.

²⁴ See *infra* TAN __.

²⁵ See *infra* TAN __.

that, if successful, would replicate some of the devices that have helped mediate the Paradox of Free Market Democracy in the developed world -- for example, "social safety nets" and constitutional property protections. But these policies do not grapple with the distinctive and most dangerous aspects of the Paradox of Free Market Democracy as it presents itself in the developing world, such as the much more massive extent of poverty, the rapidity of democratization, and the problem of market dominant minorities.

Part I of this Article will explore the material, political, and ideological devices that have helped mediate the conflict between markets and democracy in the developed world. While some of these devices will also be desirable in the developing world, others surely will not be. One of the most important challenges facing developing world policymakers is to think much more carefully about how the developed world "solved" the Paradox of Free Market Democracy and whether these "solutions" could -- or should -- exist in the developing world.

Part II will show how certain conditions characteristic of developing societies make the Paradox of Free Market Democracy especially problematic and combustible. Contemporary Indonesia is offered as a paradigmatic example. Weimar Germany is also discussed here, as a rare instance in which a Western nation pursued -- with catastrophic ethnonationalist consequences -- free market democracy under conditions in many respects analogous to those characteristic of many developing countries today.

Part III will explore policies that might be capable of grappling with the Paradox of Free Market Democracy as it presents itself in the developing world. The policies I propose will focus on the problems of market dominant minorities and ethnonationalism just described -- problems that the latest law-and-development panaceas (rule of law, state-building, judicial independence, civil society) do not address and in certain circumstances may even aggravate. If markets and genuine democracy are to coexist in the developing world, it will be crucial to find ways to give large numbers of the impoverished majority a stake in the market economy, and in particular, an *interethnic* market economy.

While the Paradox of Free Market Democracy will not be ethnicized everywhere in the developing world, the proposed policies will, with some adjustment, have bearing for all developing and post-communist countries. This is so not only because all developing countries pursuing market and democratic reforms will have to find ways to mediate the basic conflict between market-generated wealth disparities and majoritarian politics. More important, in virtually all developing and post-communist countries, foreign investors -- who tend to prosper disproportionately under economic liberalization, often provoking nationalist, anti-market sentiment -- occupy a role analogous to that of economically dominant minorities.