Unit- 4

Political Institutions and Functioning of the State

Institutions:

Introduction - While explaining the determinants of development, economic and non-economic factors are generally discussed. Role of institutions in development is often missed. The fact is that growth and development can not take place in institutional vacuum. The growth of market require an institutional framework that allows transactions to take place in an ~~ordinary~~ orderly manner. The makers of development like savers, investors, consumers, workers and entrepreneurs need a framework of rules that can guarantee them of economic stability and certainity, which can be provided only by good governance and sound economic policy making. The lack of these conditions may lead to instability and uncertainty or economic anarchy which suffocate the process of development. Therefore the role of institutions in growth and development can hardly be ignored.

Definition - It may be difficult to interprete precisely the term institutions. However attempts have been to explain the meaning of this term. Noble Laureat, Douglas North was perhaps the first economist who highlighted the role of institutions in economic development in his famous book. He describes institutions as the 'formal and informal rules (or norms) governing human behaviour'. A.P. Thirlwall has defined institutions in terms of the extent of property rights protection; the degree to which laws and regulations are fairly enforced; the ability of the government to protect the individual against economic shocks and to provide social protection; and the extent of political corruption.

In its broadest definition, institutions include a society's formal rules (e.g., constitution, laws and regulations), informal constraints (e.g., conventions norms, traditions and self-enforced codes of conduct), and the organisations that operate within these rules and constraints.

Need – An economic system is largely based on the market system. For the smooth functioning of market system the institutional framework and rules of behaviour are the necessary conditions. A well functioning market system requires social, institutional, legal and cultural preconditions. In developing nations, these preconditions are generally absent. Nathan Keyfitz and Robert Dorfman have identified 14 institutional and cultural requirements for the operation of effective market system.

1. Trust (in banks, insurance companies, suppliers etc.).

2. Law and order (enforcement of contracts).

3. Security of persons and property.

4. Balancing competition with cooperation (for a safe workplace and a cleaner environment).

5. Division of responsibility and diffusion of power (an independent judiciary).

6. Community altruism (a social "safety net" for impaired, chronically unemployed, ~~eled~~ elderly, etc.)

7. Social mobility, legitimation of ambition and toleration of competitiveness.

8. Materialistic values as a stimulus to greater production.

9. Deferring gratification to generate private saving.
10. Rationality unconstrained by tradition.
11. Honesty in government.
12. Efficient forms of competition, as opposed to monopolistic control.
13. Freedom of information (along with protection of piracy).
14. Flows of information without restrictions or favouritism.

Given the existence of these institutional and cultural preconditions, it is difficult to suggest one set of institutions that will suit all the countries. However, there is a consensus among development economists that at least five main types of marking supporting institutions are necessary if not sufficient conditions for rapid economic progress.

@ Market - Creating Institutions - These institutions protect property rights, ensure that contracts are enforced, minimise corruption and generally support the rule of law. Without these institutions in place, markets are likely to not exist or to perform poorly; by contrast, strengthening them can help boost investment and entrepreneurship. Examples include an independent judiciary, an effective police force and enforceable contracts.

ⓑ Market Regulating Institutions - These institution deal with market failures such as imperfect information, economies of scale and anti-competitive behaviour of markets. These institutions limit monopoly power and help provide the basis for building and managing public goods, such as roads and fisheries. Examples include regulatory agencies in telecommunication, transportation, water and forestry resources and financial services.

ⓒ Market - Stabilising Institutions - These institutions ensure low inflation, minimise macroeconomic volatility, ensure fiscal stability and avert financial crises. Central banks, exchange rate systems, ministries of finance, and fiscal and budgetary rules are all market - stabilising.

ⓓ Market - Legitimizing Institutions - Such institutions provide social protection and insurance, focus on redistribution, and manage conflict. These institutions help protect individuals and corporations from shocks and disasters or from adverse market outcomes. Examples include pension systems, unemployment insurance schemes, crop failure, insurance schemes, welfare programmes and other social funds.

ⓔ Political Institutions - These institutions determine how society is governed and the extent of political participation. In many countries, there is a strong focus on the key institutions that support democracy including free press, elections, competitive political parties, and participatory politics.

The aforesaid discussion leads to the conclusion that the presence and effective functioning of institutions is a sine-qua-non for the peace and prosperity of the country and growth and development of an economy. Strong institutions are central to managing financial system, building public education and health systems, ensuring efficient trade and commerce and governing legal systems. In many low income countries, these key institutions are weak or non-existent.

Governance and Institutions:

The role of governance and institutions in economic growth and development began to receive serious attention only beginning in early 1990's. This work was heavily influenced by the research and writing of Nobel Prize-winning economist Douglass C. North of Washington University. Since that time, many studies have found a positive relationship between economic growth and institutions (the rule of law, property rights, the extent of corruption, the quality of government bureaucracies, and other measures of governance and institutional quality).

Stronger governance and institutions help improve the environment for investment by reducing risks and increasing profitability. Investors are more likely to make long-term investments where they feel property rights are secure and their factory, machine or land will not be confiscated. Strong legal systems can help settle commercial disputes in a predictable, rational manner. Low levels of corruption help reduce the costs of investment, reduce risks, and increase productivity, as managers focuss their attention on production rather than influencing politicians and government officials. Strong legal systems can help settle commercial disputes in a predictable, rational manner. Low levels of corruption help reduce the costs of investment, reduce risks, and increase productivity, as managers focuss their attention on production rather than influencing politicians and government officials. Strong government economic institutions, such as the central bank, ministry of finance, port authority and ministry of trade can help establish effective government policies than influence both factor accumulation and productivity.

The most effective governments established institutions that helped facilitate (rather than hinder) strong economic management, effective social programmes and a robust private sector. Governance in most rapidly growing countries was better than in slow-growing countries. Empirical evidences also show that countries with stronger governance ratings achieved faster economic growth. Economists, now, increasingly understand the role of good governance and strong institutions in the development process.

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The Definition and Purpose of Political Institution:

Political Institutions are the organisations in a government that create, enforce and apply laws. They often mediate, conflict, make policy on the economy and social systems, and otherwise provide representation for the population.

In general, democratic political regimes are devided into two types; Presidential (headed by a President) and Parliamentary (headed by a ~~Parlia~~ Parliament). Legislatures built to support the regimes are unicameral (only one house) or bicameral (two houses). Party systems can be two party or multi-party, depending on their level of internal cohesion. The political institutions are those bodies that make up the whole machanism of modern government.

Political Institutions and systems have a direct impact on the business environment and activities of a country. For example, a political system i.e. straight forward and evolving when it comes to the political participation of the people and focused on the welbeing of its citizen contributes to positive economic growth in its region.

Every society must have a type of political system so that it may ~~b~~ allocate resources and ongo-ing procedures approppreately. A political institution sets the rule in which an orderly society obeys and ultimately decides and administers the laws for those that do not obey.

• Types of Political Systems:

1. **Democracy** – A system of government by the whole population or all the eligible members of a state, typically through elected representatives.

2. **Republic** – A state in which supreme power is held by the people and their elected ~~repen~~ representative and that has an elected or nominated President rather than a Monarch.

3. **Monarchy** – A form of government in which one person reigns typically a king or a queen. The authority, also known as a crown is typically inherited.

4. **Communism** – A system of government in which the state plans and controls the economy. Often, an authoritarian party holds power and state controls are imposed.

5. **Dictatorship** – A form of government where one person makes the main rules and decisions with absolute power, disregarding input from others.

• The Functions of a Political System:

Almond and Coleman gathered three core functions of a political system which include –

1. To maintain integration of society by determining norms.

2. To adapt and change elements of social, economic, religious systems necessary for achieving collective

goals.

3. To protect the integrity of the political systems from outside threats.

In modern day society in India, for example the main function of the two core political parties is seen as a way to represent interest groups and constituents and to create policies while minimising choices. Overall, the idea is to make legislative processes easier for people to understand and engaged with.

Eisenstadt (1966) has classified the functions of a political system as - legislative, decision making and administrative.

• **Determinants of Democracy:**

Why is that democracy is the preferred form of government in most countries of the world? There can be no simple answer to this question. More so because recent world history has many examples where governments chose democracy but reverted back to dictatorship after a brief period of democratic rule. The idea however has not spread to cover all countries of the world. A number of countries, in the Middle East have yet to substitute monarchial rule by democracy. We have seen how India and Pakistan became free at almost the same time. There can be no simple answer to the question why India remains a democracy while Pakistan has been struggling through and had a military general as head of the government.

Social and economic factors promote or come in the way of democracy becoming an accepted ~~from~~ form of government. In the case of Pakistan, the feudal system of land ownership continues. Zamindari was abolished in India soon after independence. Democracy has greater chances of survival in an industrial society rather than a feudalist's social order.

India decided to a have a secular constitution while Pakistan became a theoretic state. Political institutions have grown in India while the hold of fundamentalist religious groups is still strong in case of Pakistan. Spread of democracy all over the world has been affected by factors both internal as well as external.

In case of France, monarchy was overthrown for economic reasons. In case of the countries of Asia and Africa that were at one time under Imperialist control, decolonization came up as an after effect of the Second World War.

The disintegration of USSR was responsible for a number of ~~Sea~~ East European countries coming out of Soviet control. However democracy has been able to strike roots only in countries where the local conditions have been supportive.

Should the countries struggling with democracy be given assistance by foreign countries? What should be the extent of foreign interference in the internal affairs of a country that does not have a democratic form of government? Would it be legitimate to intervene militarily with a view to install a democratic government in a country under despotic rule? These questions have assumed great significance in the modern world.

Public opinion is widely divided over these issues. A number of countries allied with USA when it attacked Iraq on the plea that their dictator needed to be overthrown. But even within their own countries, the allies face strong reaction against external intervention. Such moves may not always be guided by considerations of promoting democracy.

As incase of Iraq, it is being widely suspected that the main reason for US intervention is to gain control over Middle East oil. Moreover such interventions go against the very spirit of democracy. It does not help the spread of democratic values if one military dictator is substituted by another puppet installed by a foreign government that is democratic at home but chooses to be undemocratic outside its own boundaries. When democracy is forced on people, it can at best lead to some temporary results. Lasting democracy is possible only when it comes after a struggle in which the ordinary citizens have been involved.