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FROM HERE TO DENMARK

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From Here to Denmark

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(This discussion paper is based on the forthcoming book “From Here to Denmark ..the importance of institutions for good governance” by Nag and Kohli. Permission of the Oxford University Press to use excerpts from the book is gratefully acknowledged)

Overview*

The world is today richer, healthier, and more literate than it was just a generation back. These are all very significant achievements and there is much to celebrate. However, many around the world still suffer from significant deprivations. Many countries suffer from the ills of high and indeed growing inequalities.

'Here' is a hypothetical place where governance is poor, and corruption is rife. Justice and basic freedoms are denied to many by capricious rulers. Discrimination based on faith, race, ethnicity, or gender orientation is common. 'Denmark' is another hypothetical place where the opposite holds true.

Poor governance is a root cause of the many ills that people 'Here' suffer. The journey from 'Here to Denmark' is essentially a journey seeking good governance for all. This in turn needs robust inclusive economic and political institutions in the country. However, it would be naïve to think that just because good governance matters, it would happen from the goodness of the heart of the governors. There has to be demand for it from the governed (the citizens).

The book identifies ten mega trends which, individually and collectively, will play an important role in creating such demand. Increased incomes and a growing middle class leads to increased aspirations, and greater demand for better governance. Demographics is another important driver as is urbanization. Traditional hierarchies and informal power structures hold less sway on the urban population, particularly the youth, who are thus more demanding of the authorities. As the quality of human capital improves, education, aided by the explosion in social media and communications technology increased demand for better governance would follow.

In this context, politics matters, as do the social contexts. Institutions would thus vary between societies and, thus, cannot be simply transplanted from elsewhere. However, some key essentials appear to be universally valid for building robust institutions: an educated and healthy population and effective community participation by citizens in the affairs of society. Another key factor is the need for a sense of harmony between the key three institutions (the State, the markets, and

the community) in a society, each complementing the other, as fellow travelers in the journey from Here to Denmark.

Undoubtedly, the journey from Here to Denmark will neither be easy nor quick. Given each country's distinct political and social milieu, and its own historical experiences, each will have to find its own way. There is no ready made blueprint. But the experiences of several countries point to a common lesson: the overriding importance of human capital and an empowered citizenry which can actively participate in the affairs of their society in building strong institutions.

History also teaches us that the arc of the journey does bend towards Denmark. The book ends with the hope that each country will indeed, paraphrasing Tagore, 'awake into that heaven of freedom . . . where the mind is without fear and the head is held high'.

*For Table of Contents see Annex 1

1. The context

Neither 'Here' nor 'Denmark' refer to any actual places themselves.

In this book, 'Here' is a hypothetical construct of a place where governance is poor, rule of law is not respected; a place where people suffer the consequences of capricious and corrupt ruling elites; a place where people lead a life marked with fear and insecurities, deprived of basic human freedoms and dignities; and where people fail to reach the full potential of their capabilities.

'Denmark', on the other hand, is another hypothetical construct, where freedom reigns, justice prevails, people live in peace and security under the rule of law and are treated fairly and with dignity by their fellow citizens and their governments.

People in 'Denmark' mostly enjoy high social-development indicators, including incomes and quality of life. People 'Here' in general do not.

Quite obviously, Denmark is the place to be. Here is not.

But then why are some countries 'Denmark' but many others are not?

Many factors contribute to such a state of affairs but a predominant one is the state of governance (or the lack of it) in a country.

Our basic proposition is that Denmark is characterized principally by good governance and the journey from Here to Denmark is thus more than only a quest for increased economic growth. It ultimately a quest for better governance.

But how will a society deliver good governance to its citizens? Answer: through strong, sound institutions. Essentially, the basic thesis is that institutions matter in delivering good governance.

2. Critical importance of good governance in the journey to Denmark

Good governance is good development. It is not only conducive to economic growth and higher incomes (its instrumental value) but even more importantly, it leads to greater freedoms from violence, from want (poverty, ill health, ignorance, and other deprivations), and from injustice

(its intrinsic value). Governance is the process of governing a society to provide its citizens such freedoms. Good governance essentially consists of four basic elements: predictability, transparency, participation, and accountability.

If good development is seen as a broad-based attempt by society to provide its citizens a set of such simultaneous freedoms, then good governance is a means to that end. Essentially, good governance enhances the social welfare of the citizens and gives them a sense of well-being, of living in a fairer, just society.

3. Formal and Informal Institutions are both key to delivering good governance .

Institutions are the rules—formal and informal—which define the framework within which human interaction takes place in a society.

Formal rules, laws, and regulations are essentially aspirational. They are an expression of the standards of social conduct a society expects to uphold. However, even the world's most elegantly written constitutions and laws are nothing but 'ink on paper' if they are not implemented in both word and spirit. And that depends largely on the informal rules which govern social behavior.

Informal rules evolve from shared beliefs, social norms, and local cultures and greatly influence how institutions function in a society. Trying to understand and analyze such functioning using standard economic models falls short for one simple reason: standard neoclassical economics heroically assumes that all actors in an economy are perfectly rational, and omniscient, and are also able to process all available information correctly and instantaneously. Such clones of Captain Spock brook no concern for anybody but themselves and act only in their own best interests. Each pursues her own self-interest but by the miracle of the Invisible Hand, it is assumed that the society she lives in reaches an optimal equilibrium and everyone in society is better off.

Such a process often works, but not always. Members of a society are 'humans' (i.e. most of us), not the robotic 'Econs' which the standard economic model assumes. Human emotions, thinking, and behavior play a very important role in how members of society act as individuals and as members of a community. A repeated process of human interactions with other members of a society gradually produces the informal rules, and norms of mutual trust in and consideration for fellow citizens emerge (positive or otherwise). These in turn influence how institutions evolve in

a particular society and how well (or not) the formal and informal rules and laws in a society work.

4. Human behavior as catalyst of change

Policies and institutional practices must be designed on the premise that human decision-making and actions are significantly influenced by norms, beliefs, and mental models of the world around them.

Studies around the world confirm that poor governance in most countries is not because there aren't enough laws and regulations on the books. The challenge is in their adequate implementation. Well-crafted, culturally sensitive, and elegant laws are important, but equally important are people's beliefs about them. For the laws to be truly effective, ordinary citizens have to believe not only in the laws and the need to follow them, but more importantly, that others will follow them too. Compared to beliefs, which are individualistic, norms are a social construct and are important for their contribution to social order. They are the language a society speaks as an embodiment of its collective values and social desires. Social life would not be feasible without norms. Our beliefs are shaped by what we believe others believe, who in turn believe what they think we believe, in a mutually reinforcing spiral. We are all 'citizens of the republic of beliefs', and this has significant implications for the state of good governance in a society.

Social norms influence collective behavior, for better or for worse. For example, evidence shows that while humans can be altruistic and kind, they are not always so. Instead, humans are conditional co-operators. 'I won't play sucker, and will be good to you only if you are good to me.' This valuable insight can be used to enhance the relevance of existing social norms, and lead to better social outcomes.

By the very nature of their evolution, norms and mental models have long staying power. They can have positive effects, of collective knowledge and ancestral wisdom being bequeathed to successive generations. But they can also outlive their relevance and be counterproductive.

While changing negative social norms and mental models is not easy, they are not immutable either. Changing norms and mental models needs collective actions. Participatory deliberations, empowering the affected people through better education and health raising their social awareness, or offering a counter norm to anchor the change, are some

such possible actions. Making space for human behavioral insights can make a big difference to successful policy design and institutional practices. And indeed, historical experiences of countries such as Denmark and Great Britain some centuries back, or Japan since the Meiji Restoration, all show that changes for the better, difficult as they might be, are indeed possible.

5. Importance of open societal systems and inclusive institutions

Broadly, societies may be categorized as either limited- or open-access orders, also referred to as particularistic or universalistic societies. In the former, access to economic and political opportunities is limited to the elites rather than being open to all. While there are no magic bullets, past experiences around the world have shown that open societal systems and inclusive institutions are central to developing better governance. These two systems must fit together for effective governance.

Open-access-order societies rely on competition, open access to organizations, and the rule of law to hold the society together. In such societies, all citizens are empowered to form economic, political, and social organizations to pursue any activity (except violence). They can pursue their own interests and open entry induces competition, which in turn dissipates rents. By their very construct, political and economic transactions are impersonal in the open-access order and based on transparent and predictable criteria. By contrast, and obviously less desirable, is the limited-access-order society, where powerful individuals or the elite possess privileges and means to create limits on access by others to resources and economic functions in order to generate rents. These elites have privileged access to social tools enabling them and only them to form powerful organizations, and they manage to keep others (i.e. most of the society) out. Elites actively manipulate the social order to regulate access and economic competition, thereby creating economic rents which only they enjoy. The elites also use these rents to create social order, control violence, and establish social cooperation for their own, narrow advantage and welfare.

The second concept is that of 'inclusive institutions' as distinct from 'extractive institutions'. Inclusive economic institutions create the incentives and opportunities for a large majority of the people in a society to innovate, adopt new technology, and aspire to achieve prosperity because they believe they can. This would include the standard neoclassical requirements of secure property rights, rule of law,

and the uninhibited entry and exit of new entrepreneurs in any enterprise.

The critical requirement for inclusivity is that these incentives and rights must be available to a large majority of the people.

Inclusive economic institutions 'require secure rights and economic opportunities not just for the elite but for a broad cross section of society'. Even if the institution of secure property rights, governed by instruments of law, and enforced by the courts were indeed available but only for the minority elites, these institutions wouldn't be inclusive for society as a whole. Inclusive institutions must include the population at large in the process of governing in a predictable, transparent, and accountable manner, thereby reducing—if not eliminating—the process of exploitation by a few. Extractive institutions do the opposite: they extract incomes and wealth from many to benefit a few.

An institutional arrangement which will function effectively in an open-access society will not do so in a limited-access, particularistic society. If the institutions do not serve their ends, the elite will exercise their power to sabotage the workings of those institutions. A good example would be the limited success of many anti-corruption commissions set up by many countries. Even if the intentions of the governments setting them up are serious (and many are not), whether such anti-corruption bodies will be effective will depend on the power balance of the affected elites in that society. While such bodies worked very well in Hong Kong and Singapore, for example, they did not in many other places.

Institutions are context-specific and thus institutional arrangements must also be tailored to the specific circumstances of that context. Unbridled faith in transplanting best practices from elsewhere is unproductive. Designing appropriate institutional arrangements thus requires local knowledge, particularly of the local political power dynamics in that society.

How strong or weak the institutions are in a society has a decisive influence on the state of its governance and economic performance. But it is not economic institutions alone which matter. Political institutions are just as important. As a matter of fact, how the economic institutions evolve and perform in a society critically depends on the nature of political institutions and the distribution of political power in that society.

6. Three fellow travelers

A society's well-being is shaped and influenced by the three principal sets of institutions comprising it: the State, the markets, and the community. Call them fellow travelers on the journey to Denmark.

Freedom from fear of being dominated by others is a fundamental premise for a fulfilling life in a society. Hobbes argued that this can only be ensured if there is a visible central authority, the Leviathan. This central authority is the State, which would legally monopolize the use of violence, ensure law and order, and assure justice for all. But this Leviathan itself needs to be shackled and the power of the state appropriately tamed to operate within the bounds of the rule of law, lest it itself becomes the feared despot.

The State must ensure security and justice for everyone, especially the weak, the disadvantaged, the marginalized, and those with special needs. Thus, perhaps the most important public good is an efficient and fair State, working in the interest of all and not just a select few. Laws must be written and adopted, but equally importantly, enforced and applied equally to all without fear or favor.

Much is expected of the State, but what it can do effectively is a function of its capability. The two must be matched. Trying to do too much results in mediocrity, damages State credibility, and erodes trust. The State must therefore prioritize what it can do well and let the markets and society step up and address the remaining needs. The role of the State should be to enable the ecosystem for the markets to operate and societies to thrive in peace and security and assurance of justice.

Markets matter. A society needs well-functioning, competitive markets to enable it to efficiently produce, buy and sell, and consume goods and services. These in turn generate economic growth, expand opportunities for citizens and enhance prosperity. Markets are thus critically important in a society's journey from Here to Denmark.

However, free markets are far from perfect. Smith correctly foresaw that competition would drive down profits and producers would be tempted to form cartels rather than operate in a truly competitive manner. Thus, just as the Leviathan of the state has to be shackled, the behemoth of the monopoly enterprises has to be tamed as well. This is not to unduly constrain the markets but to ensure that they work better and efficiently without unduly inhibiting competition.

In modern societies, many of the institutions established to do so are provided by the State, which usually does this through its political and judicial institutions. Just as the State must balance the markets, so must it work the other way around, too. Markets do so by their productive efficiency. A healthy, competitive private sector keeps the State's possible authoritarian tendencies in check. History shows that the mutual constraint of the State and the markets has usually not been detrimental to either. Of course, there are limits to how well and how much the markets and the State can balance each other. This is where our third traveller, the community, comes in to complete the triad.

Getting a community to take charge of its own development is not easy. For the State, the challenge is to overcome its tendency to consider people as only passive recipients of State actions, rather than as active participants in the process as well. One major impediment to achieving this is the asymmetry of power in most societies. Strengthening communities requires devolving political power to them through a process of decentralization. But, over time, in the evolution of the nation state, and more lately as markets have globalized, power has devolved up the chain from the community to the top.

Decentralization would seek to reverse this trend, adopting the principle of subsidiarity: powers and corresponding accountability should be vested at the lowest level, where it is best put to effective use, in a process aptly described as inclusive localism.

Often a community is weakened by the State's simply ignoring it. This can be corrected by transparently sharing as much information as possible with the community. Inclusive localism demands more than just exchange of information. It would involve active participation by the community in the design and implementation of public services, and ultimately have control over planning decisions and investment resources. The essential message is that for an effective, prosperous, caring and just society to emerge, not only must each of these work well individually, but they must also do so together. It is as much a question of balance as it is of their individual performances.

The essence of this balance is inclusive localism and active participation by the citizens at the community level. Each is needed to support but also check the excesses of the other two. Essentially then, in the journey from Here to Denmark, the three fellow travelers must walk in tandem.

7. Improving governance takes patience and time

Historically, achieving sustainable improvements in governance has taken much trial and error, patience, and time, even centuries, and yes, luck as well as the experiences of many have shown.

Moving to an open-access society is a complex, and time-consuming process in the journey from Here to Denmark. Powerful vested interests who monopolize the levers of political and economic power under limited-access orders would naturally be unwilling to cede their powers too readily and would resist that for as long as possible.

In countries such as Denmark, the UK, and Japan, it took centuries to gradually create open-access societies. In some countries (such as France and the US), a revolution or a civil war was the trigger point. Even in their cases it took a long time before all their people (men and women, blacks, and whites) had equal rights under liberal democratic regimes.

On the other hand, in most emerging and developing countries liberation from colonial rule and the move to universal suffrage under some form of democracy came almost simultaneously during the 1950s and 1960s (Latin American countries have been independent much longer but many were military dictatorships even until the 1970s). As a result, almost all such countries now have the fundamental conditions in place to create open-access systems. It is now up to the citizens of each country to bring about the needed changes.

Creating formal inclusive institutions that fit local social conditions is challenging and takes time, as they require not only a close fit with local circumstances, but also much trial and error. Institutions also take time to mature. Finally, they must evolve as the economies develop and become more complex, as well as respond to technological changes. Changing the informal norms, habits, and behavior of a society, to complement and reinforce the formal rules and laws enshrined in the formal institutional framework, is even more challenging and time consuming. Indeed, in most countries it would be the pace of these desired changes that would most likely determine the effectiveness of the overall institutional framework, and therefore the pace of the journey from Here to Denmark.

8. Hopeful signs from recent examples and lessons learnt

While, as noted above, institutional changes take time, some recent examples show that major progress can also be achieved over shorter periods under the right circumstances—over a few generations instead of several centuries. The examples of Korea and Botswana demonstrate that it is indeed possible, under some circumstances and with political will, to compress that time period significantly and achieve major improvements in a couple of decades. However, sustaining progress remains a constant challenge, even in the best of circumstances; backsliding is a risk that must always be watched.

The six countries studied in this book, (Denmark, Great Britain, Japan, Korea, Botswana, and Uruguay) divided by geography, politics, history, and culture, are each on a journey to a fairer, more equal, more just, and more developed state. Their challenges, circumstances, chances, and solutions are unique to their specific position in time and place. One success can't simply be replicated elsewhere. But there are some broad lessons to be learnt and ideas to be gleaned from their experiences as they travel on their individual paths to reach their Denmark.

A common thread in each case is the idea of balance. The State should be powerful enough to run the state but must simultaneously allow for pluralism in running the affairs of the state and impose constraints on the Leviathan, as needed. The State should essentially be a 'Shackled Leviathan'. In each case, inclusive political and economic institutions emerged only when a centralized state ruled with authority but was also constrained by the citizens, who enjoyed space and voice to participate. The end of feudalism in Denmark and Great Britain, and land reforms in Japan and Korea, empowered the common citizen to gradually demand and obtain the right of voice. Uruguay expanded the space for peoples' voice in the country by accommodating a third national political party to break the stranglehold of the traditional two parties, who had dominated the political space for almost a century and a half. Recognition of property rights, building an accountable, meritocratic bureaucracy, and ensuring not only the rule of law but rule by law as well, were key milestones in each of the countries we studied.

Human capability formation is key to progress in the journey to Denmark. Japan's and Korea's significant and historic emphasis on education has been a major factor in their development.

The much-needed balance between the three travelers we have emphasized throughout needs active participation by the citizens in having adequate voice in running the affairs of the state. But meaningful

participation would require an informed and empowered citizen, educated and healthy.

Social norms have a key role to play, for better or for worse, in how well (or not) institutions function in a society. As we noted earlier, while changing negative social norms is not easy, they are not immutable either. But that again needs to draw on an informed citizenry who will be able to challenge norms (buck the trend) and lead the way (be norm entrepreneurs).

Enlightened leadership matters. The remarkably long and consistent pace of reforms in Denmark for almost two hundred years was possible because successive monarchs built on the reform agenda of their predecessors, principally for better governance .. Emperor Meiji managed a social revolution in Japan while maintaining social cohesiveness. President Seretse Khama in Botswana was an inspirational leader who restored trust in society and established the much-needed credibility of the state. But a society cannot simply wait for the (fortunate) emergence of a good, enlightened leader. When they do, that can make a big difference and is a blessing, but a broad-based participation of the general population in the governance of society is key.

9. Peering into the future

While learning from the past is helpful, looking at the future is even more important.

We also recognize that it is obviously risky, if not foolhardy, to try to predict the future, especially on a matter as complex and multidimensional as governance. But given the importance of good governance to the future well-being of billions of people living in the emerging world today, it is still useful to peer into the future, based on what we have learned in earlier chapters of the book, combined with our prognostication of some relevant global megatrends that could have a fundamental impact on the long-term trajectory of governance worldwide.

The pace of change is accelerating in almost all aspects of life all over the world. Over the past seventy five years, almost all countries which were still under the yoke of colonization gained independence. People around the world are becoming more politically aware of their basic rights. Most of the young today know how to read and write. There has been very

significant progress in poverty alleviation, which continues to this day (though there was a short interruption due to the covid19 pandemic). The rate of technological progress and breakthroughs is accelerating. Though much remains to be done, all these political, economic, and technological changes are in turn leading to faster societal changes (such as the increasing role of women, drops in population growth rates in most parts of the world, greater mobility of people, revulsion against corruption, more vocal calls for improved governance, rise of civic societies, etc.).

In most countries, the fundamental conditions for better governance have been put in place.

Billions of people, though clearly not all, live under open democratic systems and have a voice in electing their leader. Clearly, the democratic regimes are still imperfect in many countries. But it is also true that local people and communities have a much greater say and freedom today to choose their political leaders at all levels and remove them from office than they did some decades back. While most countries cannot yet boast of having realized the open-access-order societies, which 'rely on competition, open access to organizations, and the rule of law to hold the society together', there is hope with democracy taking root around the world.

Many emerging countries have also established another critical building block for good governance in a remarkably short time, something which took Denmark and the UK so much longer (centuries). They have put in place, to varying degrees, formal institutions (constitutions that protect the basic rights and privileges of all, basic laws and rules, civil service, police, judiciaries, regulatory bodies, central banks, etc.) that, at least on paper, meet the definition of inclusive institutions.

In most countries, however, the biggest challenge now is how to make these formal institutions more effective and, even more critically, how to change people's beliefs and behaviour so that informal societal rules complement what the formal rules and laws heroically proclaim.

Unlike past experiences in countries such as Denmark, UK, , and Japan, future improvements in the emerging countries would most likely be driven from the bottom (by communities, the youth, and/or civic groups).

There are two fundamental reasons for this. First, unlike Denmark, the UK, and pre-World War II Japan, countries today generally do not have

any imperial power (an all-powerful king) to impose changes from the top. And second, future changes will be driven by the more energetic youth and grass-roots (community) groups motivated by existential causes (like climate change) and social ills (like corruption, inequality, gender, injustices), which they feel intensely passionate about.

9.1 Ten global megatrends

We believe that the above fundamental conditions, which have emerged over the last few decades around the world , will be shaped and driven by the ten following global trends (but which will obviously influence each country differently and at a different pace in each).

First, widespread growth of education of younger people, and their access to the Internet and social media. With all emerging economies continuing to give high priority to education at least to secondary-school level, and with young people having ready access to news from around the world as well as the ability to communicate via social media, they will exert a powerful influence on the demand for improved governance, going forward.

Second, the ongoing explosion in the size of the middle (and upper middle) income group classes. Past experiences in many countries suggest that these large emerging middle-income groups could play a very positive role by demanding greater transparency and accountability from their governments and other institutions in both private and public sectors.

Third, the coming surge in urbanization mostly in Asia and Africa. Agglomeration of larger numbers of restless people in urban centres would be another powerful force for greater demands for improved governance at all levels.

Fourth, rising inequalities within countries. Such intra (within) country inequalities are already a major political issue and will become even more pronounced in the coming years.

Fifth, climate change. This is an existential challenge the world faces over the medium to long term. This megatrend also has fundamental implications for governance at all levels—local, national, as well as global.

Sixth, the accelerating pace of technological progress. New scientific discoveries are leading to technological breakthroughs that have the potential to help the world tackle current and future global challenges

such as climate change, pandemics, inequality, and to promote inclusive growth.

Seventh, Information sharing and Communications Revolution. A critically important ongoing revolution in our lifetimes involves information-sharing that could further empower people, combined with other megatrends highlighted above, to demand and realize changes in governance.

Eighth, emergence of civic society as an agent of empowerment of the community. Though not always readily apparent given the recent onslaughts and crackdowns on civic society in many places around the world, a significant positive development of the past decades has in fact been the emergence of civic society. It has become a major voice of ordinary citizens and an important force in public affairs in many countries.

Ninth, accelerated spread of social media. A major global phenomenon of the past two decades is the phenomenal spread of social media which can only be expected to accelerate even further. It is rapidly becoming a major force both for peer-to-peer communications and for social activism.

And finally Tenth, Rise of the Emerging Economies. During the next forty years, further major transformation of the global economy is anticipated that gives hope for an acceleration in social and political reforms in the emerging economies.ⁱ This coming transformation will lead to major shifts in the structure and size of the global economy, as the world economy potentially triples in size.

10. The Journey From Here to Denmark.....

The combination of the existence of the basic foundations necessary for good governance established in most emerging countries in the past fifty years or so, with the forces being unleashed by the ten global megatrends summarized above, suggests that demands from people at large for better governance is likely to increase in most societies in the coming decades, perhaps even explosively in some cases. This will in turn will reinforce demand for better, stronger institutions. While many factors influence the evolution of institutions, and they will vary from country to country, enhanced human capital through improved education and health, will continue to be key for all. This will empower citizens to exercise greater human agency and enable them to participate

more effectively and extensively in decisions and activities critical for their well-being.

Given our observations above about the achievements of the past several decades and the global mega trends, we are hopeful that faster progress from Here to Denmark is plausible. At the same time, we recognize that such breakthroughs are by no means preordained. Nor should such changes be expected to occur in most countries quickly, given the complex and multidimensional nature of changes required in societies to achieve sustainable improvements in governance.

Undoubtedly, the journey from Here to Denmark will neither be easy nor quick. Given each country's distinct political and social milieu, and its own historical experiences, each will have to find its own way. There is no easy blueprint. But history also tells us that the arc of the journey does bend towards Denmark, and we hope that each country will indeed, paraphrasing Tagore,

“awake into that heaven of freedom . . . where the mind is without fear
and the head is held high”.

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