CHAPTER ONE

Politics Matters for Development

As the new millennium begins, the Latin American and Caribbean region finds itself in a dramatically different position politically than a little over two decades before. Though not without faults or immune from threat, democracy is the form of government practiced throughout the region, except in Cuba. In every other country, the rules of the political game emanate mainly from democratic constitutions, and public officials are elected through competitive elections. Considering the limited reach of democracy in the mid-1970s and the region's turbulent political history, this is a remarkable development.

In the mid-1970s, leaders were selected through free, fair and competitive electoral processes in only three countries: Costa Rica, Colombia and Venezuela. But by the end of that decade, political transitions in the Dominican Republic and Ecuador marked the start of a democratic trend—later baptized the “third wave” by Samuel Huntington—throughout the region. The trend was given renewed energy and a more global breadth beginning around 1990 as a result of the surprising and relatively peaceful collapse of Communist regimes in Eastern Europe, and democratization processes in several countries in Africa and Asia.

Benefiting from the lost prestige for alternative forms of government and a friendlier global and regional context, the new democracies survived despite multiple obstacles. For instance, few of the democratizing countries had extensive prior experience in competitive politics. Many had to face the conflictive issue of widespread human rights offenses that had been committed by the previous regime: manage and subdue violent internal conflicts; or implement the terms of peace agreements in order to establish a basis for peaceful coexistence between formerly warring parties. Nearly all of the new democracies had to cope with severe economic traumas stemming from large levels of public indebtedness and the sudden cutoff of foreign capital flows to the region. Despite these inhospitable circumstances, the region's embrace of democracy held fast, surviving through instances of slippage of democratic norms and rebelliousness by the military.
The ascendance of democracy has brought invaluable benefits in terms of the protection of human rights, the scope of individual political freedoms, and the breadth of opportunities for citizen involvement in public decision-making. Whatever flaws can be found in the region's democracies, it is a tremendous advance that public officials and the government in these countries are expected to serve the citizens and to be accountable to them.

Rebuffing a widely held myth that authoritarian government was superior in stabilizing and reforming economies, the region's democracies have succeeded in implementing socially disruptive and controversial economic transformations. Fiscal prudence and monetary discipline put the brakes on decades of high inflation. More far-reaching reforms—such as those which opened protected economies to foreign trade and investment, privatized state-owned enterprises, modernized social security systems, and liberalized labor markets—were also adopted to varying degrees in many of the countries of the region. The fiscal adjustment and the adoption of profound economic reforms enabled countries to emerge from the stranglehold of debt and to return, at least temporarily, to the path of positive economic growth.

Despite these significant accomplishments, there is still reason for disappointment with respect to both the results and processes of democratic governance in the region. The beral reforms emphasizing fiscal responsibility and market liberalization contributed to an overall average annual growth rate of 3.2 percent in Latin America in the 1990s (ECLAC, 2001). However, when the increase in the region's population is factored in, this growth rate equated to an annual per capita average of 1.5 percent. Coming after a period of negative growth during the 1980s, the economic advances of the 1990s brought only a small net gain over the 20-year period between 1980 and 2000 (Table 1.1).

In fact, in eight of the 18 countries in this study, the average citizen was worse off in 2000 than in 1980. While 20 years of development doubled or even tripled the average income of citizens in certain East Asian countries, it brought an average gain of only 8 percent in the average Latin American country. This poor long-term performance resulted in part from the continued volatility of the region's economies and their vulnerability to international price fluctuations and financial crises in other emerging markets. The prospects for economic gain by the region in the first two years of the 21st century are also not very promising.

The relatively slow pace of economic expansion has not been sufficient to significantly reduce the high level of poverty in the region. The Inter-American Development Bank estimates that the percentage of the poor (those living on less than $2 per day) declined only slightly from about 43 percent in 1990 to 39 percent in 1999. Persistently high income inequality, which worsened over the period, prevented economic growth from having a larger impact on reducing the rate of poverty (Székeley, 2001). Without higher levels of economic growth, little hope can be offered to the estimated 220 million people of Latin America who live in poverty, or to the high percentage of people who are underemployed or unemployed.
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¹ For France and Spain, the period covered by this table is 1978–98.

Sources: Figures calculated by the authors based on ECLAC (2001) for Latin America and on IMF (2001) for the other countries.
The Importance of Democratic Political Institutions to Development

When investment, employment and output did not materialize to the extent expected during Latin America's reform process, it signaled that dynamic market economies could not be created solely by changes in the macroeconomic framework. Similarly, the complex task of transforming the economies of former Communist states plainly demonstrated the importance of the fundamental institutional underpinnings to market economies. Satisfying the key requirements for development—such as sound public financial systems, competitive markets, legal predictability, property rights protection, effective investment in infrastructure, and steady advances in the skills and productivity of the workforce—depends upon broad and deep institutional reforms. Though the scope of the state's activities was in many cases reduced, the need for effectiveness and neutrality in the performance of its remaining functions became evident. Rules governing competition and transactions in diverse markets, including those for labor, capital, goods and services, had to be put in place at the same time that the regulatory agencies and courts required to enforce and adjudicate them had to be strengthened and made more independent. Tax systems had to be overhauled, and collection agencies strengthened. At the same time, the state had to manage the use of its available resources to ensure the efficient provision of infrastructure, as well as the delivery of equitable education and health services of reasonable quality.

However, by their very nature, these institutional reforms—referred to as "second generation" reforms by some observers—are considerably more complex to implement than the typical macroeconomic measures adopted in response to the public financial crises of the 1980s and early 1990s (Naim, 1995; Graham and Naim, 1998). Raising taxes, reducing state subsidies, eliminating price controls, lowering public sector wages, and reducing trade tariffs could be accomplished in some cases by executive decree and in others by legislative approval of a single bill. On the other hand, enhancing the management of public sector institutions, creating a more independent and effective judiciary, and establishing regulatory frameworks usually involves coordination and agreement among a wide array of public institutions and societal actors, as well as a series of legislative and bureaucratic actions over a long period. In addition, realizing the benefits of institutional reform is contingent upon simultaneous changes in diverse organizations and areas of law.

Clearly, much is at stake for society in the creation of regulatory frameworks, the redesign of service delivery systems, and the restructuring of public sector institutions. Such changes inevitably entail taking on powerful interests while giving privileges to certain social groups or interests to the disadvantage of others. If the benefits of institutional change end up being overly concentrated on relatively narrow interests, then larger societal groups

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The use of the term "second generation" is a matter of controversy. Some experts disagree with the implied message that the focus on institutional reform should succeed in time or is in some sense secondary to the neo-liberal or market-oriented economic reforms. Some also object to much of the neo-liberal approach ("Washington consensus") and thus do not want to adopt a terminology that associates support for institutional reforms with endorsement of that economic policy agenda.
such as consumers, workers and entrepreneurs will suffer. For instance, administrative re-
forms of the public sector—like enhancing governmental transparency, controlling corrup-
tion, or establishing a professional civil service—require incumbent politicians to relin-
quish instruments of power and open up their conduct and decisions to more intense
public scrutiny.

Thus, it is clear that politics matter in the process of creating, implementing and sustain-
ing sound institutions and adopting public policies that work to the benefit of all citizens.
More precisely, however, it is the quality of democracy that matters. Not only is the exercise of
democratic political and civil rights intrinsically valuable in expanding the range of possi-
bilities and choices open to citizens, it is also instrumentally valuable for identifying and
conceptualizing citizen needs and building the policies and institutions that will most ef-
effectively address them (Sen, 1999). Thus, contrary to a line of thinking prevalent in the past,
the task of building a legitimate, representative and effective democratic system is not
something that can be put on hold until there is an adequate level of development. Rather,
given its indispensability to strengthening institutions and implementing efficient and
sustainable public policies, a well-functioning democracy appears to be indispensable for
equitable and sustainable development.

As Dani Rodrik (2000) points out, “market” institutions are necessarily “embedded” in
a set of non-market “political” institutions. Efficient market institutions would appear to
require democratic political institutions that can ensure both that fair and efficient rules are
created, and that these rules are even-handedly and consistently enforced and adjudicated.
Suitable and efficient market institutions must be well-adapted to the particular social,
economic, historical and cultural conditions and needs of a given country. Given the im-
possibility of universal blueprints, the creation and maintenance of institutions depends on
broad and effective citizen participation through well-developed representative institu-
tions. In light of this reasoning, democratic political institutions can be viewed as “meta-
institutions” underlying the larger universe of institutions supporting a market economy.
As stated in IDB (2000), “politics exercises its greatest impact on development through its ef-
fact on institutions. The logic is clear: if politics matter for institutions, and institutions
matter for development, politics must matter for development."

Thus, the effective practice of democracy would appear to be at the basis of the creation
of an effective public sector and the establishment of a legal framework propitious for soc-
ial and economic development. The adoption of effective, fair and sustainable public poli-
cies, the efficient and fair allocation of public resources, and the effective delivery of pub-
lic services depend on the existence of representative institutions that allow the
preferences and interests of citizens to be taken into account. Public policies need to be
adopted and implemented in a way that fully considers the views of diverse civil society or-
ganizations, without falling capture to any particular group or narrow set of interests. This
requires that citizens and civil society organizations have opportunities to express their
preferences and influence decision-making, and that representative institutions have the
capacity to effectively aggregate these preferences into consensual policies with broad
bases of social support. Public decisions adopted in this manner will not only be efficient
(responsive to the preferences and needs of society), but they also are more likely to enjoy
legitimacy and social compliance, and to be sustainable over time.
Democratic Governability as the Basis for Efficient Institutions

"Democratic governability" is an elusive term, often loosely defined in practice, that has been used to attempt to capture this broad notion of a democracy that is generally seen as stable, legitimate and efficient. It has been defined narrowly by some political scientists as pertaining to the ability of the executive to work in reasonable harmony with the legislature to address the country's social and economic problems. But the concept has also been applied more broadly to the capacity of a democratic political system to absorb and process societal demands, adopt decisions in the broader public interest, and manage social conflict.

In this book the term "democratic governability" will be used to refer to democratic systems where decisions necessary to resolve social problems can be enacted, implemented and sustained because they are arrived at through institutionalized democratic procedures that fully consider the needs and interests of relevant political and social actors.

Latin America's relatively low and volatile economic growth rate and unyielding levels of poverty and social inequality appear to be attributable in great part to continued institutional deficiencies. However, at their root, these institutional weaknesses reflect and are exacerbated by problems of democratic governability. Without changes in the rules and conduct of democracy, it is doubtful that major improvements can be made in the quality of institutions or, by extension, in the pace of economic and social progress.

Some signs of democratic dysfunction are highly visible. News headlines across the region report executives accused of wide-scale corruption or of bribing legislators to back their initiatives; election processes and results being questioned by opposition political forces and international observers; irregular or premature successions of presidential power because of mass protest, military action or impeachment; and ongoing struggles by the state to preserve the rule of law against unofficial arbiters such as drug traffickers, organized crime groups, and guerrilla or paramilitary forces. Other problems of democratic governability, while more subtle, still are significant in impeding progress toward establishing the institutional bases and political conditions for equitable and sustainable social and economic development.

Public opinion surveys and other data suggest that instead of becoming more deeply rooted and legitimized, democratic institutions are losing credibility and weakening in many countries in the region. As will be shown in Chapter Two, not only do citizens in many countries appear to have little confidence in such key political institutions as political parties, congress, the public administration and the judiciary; they also give democratic governments low marks in terms of their ability to improve living standards, reduce poverty, deliver services, control crime and reduce corruption.

Democracy with Underdeveloped Institutions

In parallel with these sentiments, the ratings of Freedom House suggest that on average political freedoms and civil liberties have tended to erode once countries have made the transition to democracy. Clearly, the advent of democracy in country after country in the region
As brought marked improvements in political freedoms, due process and freedom of association when compared to the situation under the previous authoritarian regimes. Figure 1.1 shows this transition from authoritarianism to democracy through the 1980s and early 1990s, and the consequent advance in democratic values.

Figure 1.2 indicates, however, that once the transition to competitive politics has been made, the practice of such freedoms and rights diminishes over time rather than strengthening and being consolidated. The figure plots the average score in each year for political rights and civil liberties only in those countries that are already deemed to have completed the transition to democracy (see Table 1 in the Introduction). For example, in 1978 only Costa Rica, Colombia, the Dominican Republic and Venezuela are included in the regional average, while by 1985 all but four of the countries—Chile, Nicaragua, Panama and Paraguay—are included. Thus, the decline in the regional average in this figure reflects the tendency for political rights and civil liberties scores to decline once countries complete the transition to democracy.

In particular, Freedom House scores for civil liberties (measuring such institution-related factors as equality under the law, due process, and property rights) have been relatively low and have eroded over time. The 2000 average of the political rights and civil lib-

Figure 1.1. Average Freedom House Score for Political Rights and Civil Liberties considering All 18 Countries in Study

Note: The Freedom House scores have been inverted so that a score of 1 signifies the lowest and 7 the highest level of political freedoms. Using this scale, Freedom House would designate a country with an average score of 5.5 or better as “free,” between 2.5 and 5.0 as “partly free,” and 2.5 or below as “not free.”
The Freedom House scores have been inverted so that a score of 1 signifies the lowest and 7 the highest level of political freedoms. Using this scale, Freedom House would designate a country with an average of 5.5 or better as "free," between 2.5 and 3.0 as "partly free," and 2.5 or below as "not free."

The deficient performance of democratic institutions has impeded progress in putting into practice the broader rubric of institutions that is the cornerstone of a competitive and dynamic market economy. Institutional weakness is tangibly evident in the many corruption scandals involving governmental officials, the deficiencies in the quality of public services, and long delays in processing cases in the court system. However, cross-national measures of government quality also point to the relative weakness of Latin American institutions. Caution must be taken in making international comparisons based on such subjective measures—since standards can vary systematically between countries—such measures nevertheless be useful for pointing to general tendencies.

According to the Corruption Perception Index (2001) of Transparency International, Latin America is characterized by levels of corruption that greatly exceed those of the more stable economies, and also exceed those prevailing in a sample of countries in East Central and Eastern Europe, and the Middle East and North Africa (Figure 1.3). Latin America also falls behind these same regions with respect to an indicator of the rule of law.
developed by researchers at the World Bank (Figure 1.4) (Kaufmann, Kraay and Zoido-Lobatón, 2001). According to measures published by the World Economic Forum (2000) a sample of countries from the Latin American region also lags behind a sample of the high-income countries as well as Central and Eastern Europe and East Asia with respect to the independence of the civil service and the independence and integrity of the judiciary (Figures 1.5 and 1.6).

By contrast, the advances over the past two decades in the region as a whole with respect to democratic freedoms are reflected in Figure 1.7, which compares the average of the scores for Latin American countries for political rights and civil liberties with averages for other regions. Despite the fact that such rights (particularly civil liberties) have not been consolidated in many Latin American countries, the region ties for second place with Central and Eastern Europe. The region’s average score, nevertheless, places it in the category of “partly free,” just below the score that would be needed for it to be regarded as “free” according to the Freedom House criterion.

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4 The index value is an aggregate of numerous indicators available from a variety of different sources. The individual measures are based on polls of experts who rate countries (on a global or regional basis) and on cross-country surveys of firms or citizens carried out by international and nongovernmental organizations. The aggregate indices for each dimension were estimated by means of a statistical procedure (unobserved components model) that expresses the available measures for each country as a linear function of the unobserved common component of governance, plus a disturbance term capturing perception error and/or sampling variation in each indicator. See Kaufmann, Kraay and Zoido-Lobatón (1999a and 1999b).
Thus, if problems of democratic governability are responsible in large part for the region's institutional deficiencies and mediocre development performance, then it is critical to identify their causes and to work on overcoming them.

Variations in Presidentialism Affect Democratic Performance

During the 1970s and 1980s, a great deal of the academic discussion about the reasons for the various collapses of democratic systems centered on the type of regime that was prevai-
lng in the region (Linz and Stepan, 1978; Linz, 1990; Di Palmia, 1990; Linz and Valenzuela,
1991). Some argued that presidentialism, with its popularly elected head of government
with a fixed term of office, contributed to problems of governability that could have been
avoided, or at least managed better, in a parliamentary system. With separate bases of
legitimacy and a pre-determined election calendar for the president and legislators, critics
suggested that presidential regimes were more vulnerable to policy stalemate between the
executive and legislature and less flexible in coping with governance crises. Critics argued
that the risk of gridlock and mounting polarization and instability was especially pro-
duced in the multi-party contexts typical of Latin American countries (Mainwaring, 1993;
Shugart, 1994).

By contrast, the prevailing viewpoint was that parliamentary systems, in which the gov-
ernment is elected by a legislative majority and must maintain this support, provide built-in
incentives for cooperation between the executive and the legislature and for the forma-
Figure 1.5. Independence of the Civil Service

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<td>LAC (11)</td>
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<td>CIS (2)</td>
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Average

Note: Based on the statement: The civil service is independent from political pressure: 1 = strongly disagree; 7 = strongly agree. The numbers in parentheses represent the number of countries included in the average. Thus, particularly in the case of the CIS countries, the average is not very representative of the region as a whole. The other regions were excluded because measures were available for only one or at most two countries. HIC = high-income countries; EA = East Asia; CEE = Central and Eastern Europe; LAC = 11 of the 18 Latin American countries examined in this study; CIS = the former Soviet Republics.


... of inter-party governing coalitions. Parties in the governing coalition gain cabinet positions and a share of power while parties that withdraw their support risk bringing on new elections in which they may lose seats and influence. Thus, it was argued that governing coalitions tend to be more durable and inter-party bargaining and agreement is facilitated. Parliamentary systems were believed to be more flexible in coping with situations of divided or minority government. If the government loses legislative or popular support, new elections can be called, potentially producing a new balance of power in the legislature and the formation of a new government with a fresh basis of legitimacy.

Despite the prevailing scholarly pessimism about the prospects for stable presidential democracy in Latin America, none of the new democracies formally adopted a fully parliamentary or semi-presidential form of government. However, constitutions in a few countries have incorporated semi-presidential or semi-parliamentary mechanisms, and in some instances such mechanisms have been used in practice. Moreover, the issue of changing to either a parliamentary or semi-presidential system remains alive in at least a couple of countries in the region.

Fortunately, the pessimistic scholarly assessment of presidentialism was not completely borne out by the region’s democratic experience over the past two decades. Despite significant difficulties and occasional deviations from constitutional dictates, the democracies held on, the armed forces mostly stayed in the barracks, and successions of power were generally...
Figure 1.6. Judicial Independence and Integrity

Note: Based on the statement: The judiciary is independent of the government; the judiciary rarely accepts irregular payments, 1 = strongly disagree; 7 = strongly agree. The numbers in parentheses represent the number of countries included in the average. This, particularly in the case of the CIS countries, the average is not very representative of the region as a whole. The other regions were excluded because measures were available for only one or at most two countries. HIC = High-income countries; EA = East Asia; CEE = Central and Eastern Europe; LAC = 11 of the 18 Latin American countries in this study; CIS = the former Soviet Republics.


... determined by competitive elections. A more balanced appraisal of presidentialism gained attention that called into question the notion that this regime type is inevitably more prone to instability or governability problems (Shugart and Carey, 1992; Santori, 1994; Mainwaring, 1990; Mainwaring and Shugart, 1997; Nohlen, 1998; Lanzara, 2001; Chasqueti, 2001).

As these more agnostic observers pointed out, what may be as important to the governability and stability of democratic systems are the particular institutional variations within each type of regime and the broader social and political contexts in which they operate (Mainwaring and Shugart, 1997; Nohlen and Fernández, 1998). Notwithstanding the election of the president apart from the legislature, presidential systems are not cut out of the same mold. For one, they vary significantly in terms of the powers granted to the chief executive with respect to lawmaking and control over the tenure of members of the cabinet (see Chapter Eight). In addition, they vary in terms of the formal powers of the legislature to control and monitor the executive branch. As a consequence, in some systems the president has the potential to dominate the legislative process, while in others he may be relegated to playing a more subsidiary role. While some Latin American systems adhere to the "pure" presidentialist ideal by giving the president exclusive powers of appointment and dismissal, in others the legislature can remove cabinet officials. These differences in the allocation of constitutional power as well as the configuration of partisan forces mean that...