

ECONOMICALLY BENEVOLENT AUTOCRACIES

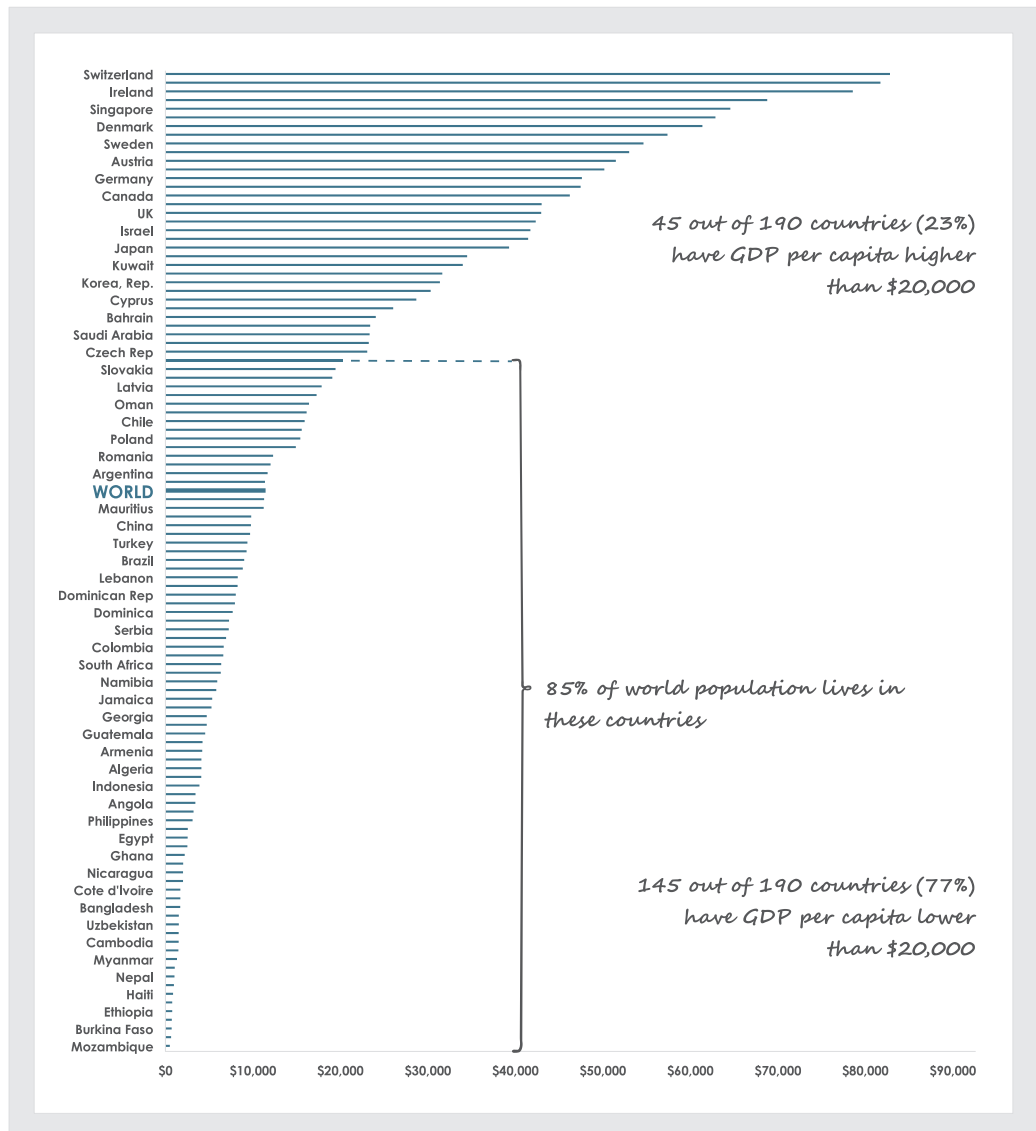


Over the last few months we have witnessed a lot of discussions on how governments have handled the COVID pandemic. Many have argued that countries such as China have done a better job because they have a “command and control” system that is more effective in times of crises.

Others have argued that the western civilisation is in decline, authoritarian regimes are gaining in popularity, and that this is not a good sign because lots of developing countries may choose autocracy over liberty. In such discussions, it is always important to carefully define our terminology. Big words such as autocracy or democracy must be clearly defined.

In this report, we would like to share with you our framework that allows us to better structure our thoughts, when confronted with such sensitive and multifaceted questions. How we think about these questions may determine in which countries we choose to live, raise our kids, do business or simply invest. We hope you find our thinking framework somewhat useful.

Chart 1: GDP Per Capita of 190 Countries (current US \$)



Source: World Bank



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Think to connect!

It is often said that (i) we must understand what we believe, (ii) we must know why we believe what we believe, and (iii) to constantly question what we believe, because beliefs are like muscles, they can atrophy and turn into outdated ideologies.

To begin with, let us divide the world economy into two – developing and developed countries.

We consider countries with GDP per capita below \$20 000 as still developing. Chart 1 shows that under this definition about 77% of countries around the world are still developing. That is to say, about 145 out of 190 countries in the world are still developing (GDP per capita below \$20 000).

As shown in Chart 2, under our definition, around 85% of the world's entire population currently lives in developing countries, and produces only one-third of the world's national income (GDP).

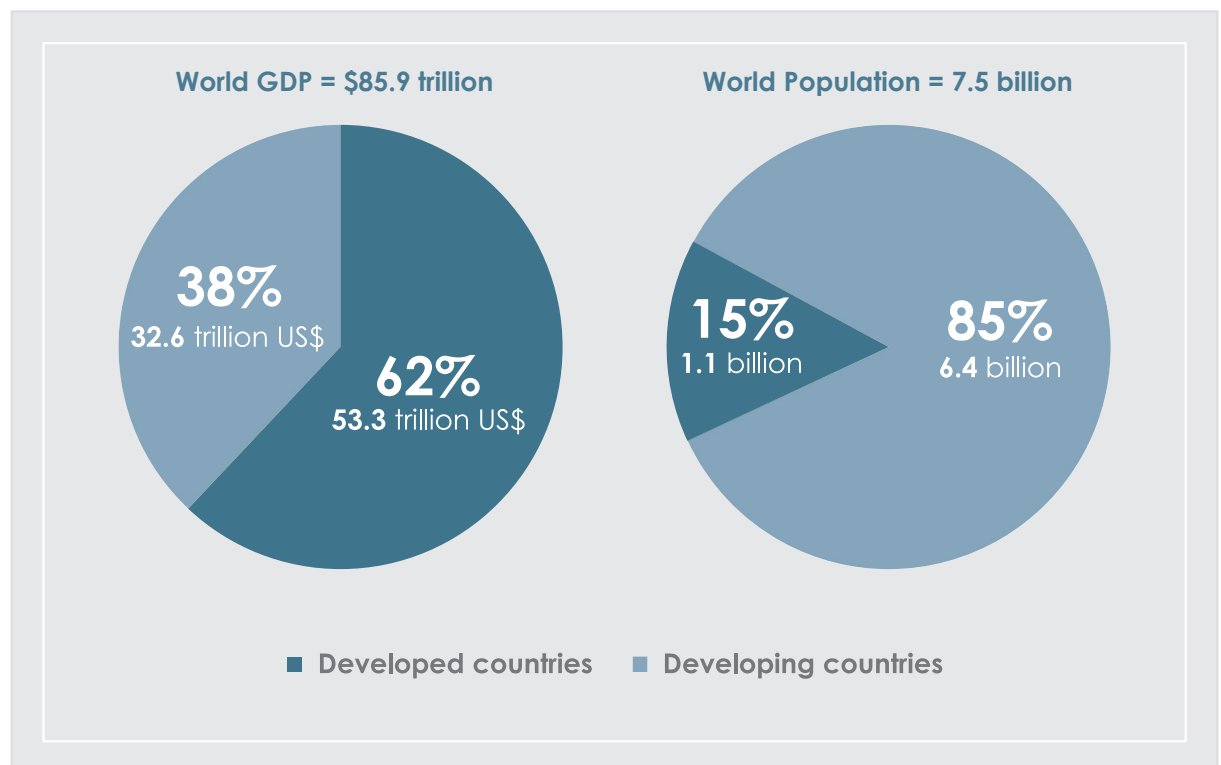
Developing countries are alike in several important attributes. Let's look at three such attributes.

First, immature legal systems. This means major laws are still being rewritten, court cases and precedents are still forming, property rights are still being defined, constitutions still getting amended, the judiciary not entirely independent and so on.

Second, outward migration is larger than inward migration, as very few people are ready to immigrate to developing countries. People still emigrate from developing to developed countries, and thereby “vote with their feet”. This is a very telling yet a simple to observe indicator.

Third, shallow financial systems. This means most banks are either owned by foreign banks or are often in all sorts of crises. Capital markets are largely dysfunctional either because people save in foreign rather than local currency or because government-owned enterprises are too big (to see our last report entitled “**Government – How Big is Too Big**” [click here](#)).

Chart 2: Share of World GDP and World Population for Developed and Developing Countries



Source: World Bank

So now that we have defined what we mean by developing countries, let us rephrase our original question – are authoritarian regimes more effective at managing crises?

Will the COVID pandemic push more developing countries towards authoritarianism? And if so, what will be the business and economic consequences?

In case of small developing countries, autocracies could indeed be more effective, simply because many democratic institutions may still be dysfunctional or simply non-existent. When political, judicial and governmental institutions are dysfunctional, small countries are left with only two choices – autocracies or complete paralysis.

In economic theory, we have long known that economies managed by “benevolent dictators” can grow much faster than those managed by democratic institutions. The trouble is that such a concentration of power can very quickly drive an entire country into *The Abyss of Hell*, as described in Dante’s *Inferno*.

How do we define “benevolent dictators” or “benevolent autocracies”?

They are usually defined as autocratic regimes whose leaders choose their country’s economic prosperity over their personal offshore bank accounts, and they use all the political and economic powers of the state to transform and accelerate economic growth.

For example, the rulers of Dubai, Oman, Abu Dhabi or the founder of Singapore could easily qualify. They all started as *benevolent autocracies*, made credible commitment to protect investors’ financial and human capital, for rapid economic growth to occur. Without this commitment, it is very hard to attract investments into countries with dysfunctional democratic institutions. Then, over time, these *benevolent autocrats* gradually increased the role of various institutions.

Our conclusion is that *benevolent autocracies* are possible only in small states, and there are lots of success stories such as Singapore, Dubai, Oman, to name a few. In larger countries, however, autocracies gradually turn into kleptocracies, stagnate and eventually disintegrate. The collapse of the Soviet Union was the perfect illustration of this phenomenon. The modern world still hasn’t seen a single example of a large developed autocracy.

So why do benevolent autocracies in large countries turn into kleptocracies and eventually drive their countries into The Abyss of Hell?

Benevolent autocracies are well aware that they don’t have any legitimate power to govern. They are never really chosen by the people they are trying to lead. Consequently, as the economy continues to develop, a large middle class begins to form, people start to get richer, the power of the private sector starts to grow. People demand more rights and freedoms. That is when autocracies start to panic as the legitimacy of their regime is brought into question.

Autocratic regimes start to squeeze the financial sector and transfer funding away from the private sector, towards the inefficient SOE (State-Owned-Enterprises) sector, tax rates start to rise, the judiciary gets tougher on the private sector and so on. That is why central banks of autocratic regimes often keep interest rates at artificially high levels. That is why the laws and regulations of autocratic regimes are always a contradictory mess, it makes it easier for the judiciary to rule in either direction.

As we had argued in our report on [Ecosystems \(click here to read\)](#), at certain point of a country’s development, just around the \$20 000 GDP per capita mark, knowledge and creativity become the key drivers of economic development. That is where large autocratic regimes stagnate, because by this point they have already become full-fledged kleptocracies, often without realising it. The road to hell, as we know, is paved with good intentions.

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