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# ECONOMIC REFORM

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25 years of strengthening democracy through market-oriented reform

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May 15, 2009

## The Business of Democracies that Deliver: Reflections on CIPE's 25th Anniversary

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### Article at a glance

- Democratic governance and market economy share the same underlying values of transparency, accountability, fairness, and responsibility.
- A functioning market economy requires a complex institutional framework put in place by a political process that establishes the rules of the economic game through laws and regulations.
- The Center for International Private Enterprise (CIPE) can now showcase 25 years of strengthening democracy around the globe through private enterprise and market-oriented reform.

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published by the

**Center for International Private Enterprise**

an affiliate of the U.S. Chamber of Commerce

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## Introduction

This year, the Center for International Private Enterprise (CIPE) celebrates the 25<sup>th</sup> anniversary of its founding. CIPE was created in 1983 and is one of the four core institutes of the National Endowment for Democracy (NED) and an affiliate of the U.S. Chamber of Commerce. This anniversary provides an opportunity to reflect on the history of our organization, the successes and challenges over the years, and – most importantly – what lies ahead and why CIPE's work is more important today than ever before.

CIPE was founded on the idea that economic freedom and political freedom are inextricably intertwined. This idea, that progress comes through a combination of political and economic reforms, has gained weight over the years and is becoming more widely recognized. However, that idea was not unanimously accepted in the 1980s and neither is it now. Many proponents of democracy assistance keep asking: why should we be concerned with market economy? CIPE's belief is that private enterprise plays an important role in developing and sustaining democracy.

The rise of democracy around the world since 1974, or as Samuel Huntington called it, the “third wave” of democracy,<sup>1</sup> significantly increased the number of electoral democracies, bolstering widespread optimism about the future of democratic development. Yet, competitive elections are just a first step of democratic progress. Many of these countries still lack the core attributes of a democracy – political freedoms and civil liberties – even if they hold competitive elections.

Therefore, the consolidation of democracy – meaning the process through which democracy becomes deeply institutionalized and broadly legitimate in a society – should be the ultimate objective of international efforts to support democracy around the world.<sup>2</sup> A primary objective of that consolidation is building democracies that deliver in economic terms. This article will look briefly at the history of CIPE's work and discuss how CIPE's programs and partners have been advancing this objective.

## A Brief History of the Democracy Programs

The realist approach, prevalent in U.S. foreign policy since the 1950s, continued to prevail during the cold war. This approach, associated with Hans Morgenthau, was based on the idea that states are rational actors and act in their self-interest to maximize their own power rather than to further certain ideals or principles. Yet, during this period the realist worldview could not entirely overshadow the Wilsonian traditions of aiding other countries in their struggle for self-determination and of supporting democracy as a means to strengthen peace and freedom around the world.

In the 1970s, there was a fundamental shift. First, the Carnations Revolution in Portugal overthrew the dictatorship of Antonio Salazar; second, the military rule of the Greek junta collapsed; and third, Spain began its transition to democracy after Francisco Franco's death. These democratic transitions, occurring in the midst of the cold war, were very important to Western Europe and the U.S. However, the U.S. found itself without any real mechanism to provide political development assistance to these emerging democracies.<sup>3</sup> It was the German political party foundations (Stiftungen) that were in one of the best positions to help.

After World War II, the Christian Democratic Party, the Social Democratic Party, and the Liberal Party created the Konrad Adenauer Stiftung, the Friedrich Ebert Stiftung, and the Friedrich Naumann Stiftung, respectively. These foundations played a crucial role in Germany's own transition to democracy. They later used that expertise to help Portugal, Greece, and Spain build democratic institutions following the collapse of authoritarian regimes.

No equivalent aid organizations existed in the United States, leading some to argue that this had to change if the United States were to be effective in supporting democracy around the world. President Ronald Reagan shared that view. In a major foreign policy address delivered in 1982 before the British

Parliament at Westminster Abbey, President Reagan set out the mandate of the democracy programs, “The objective I propose is quite simple to state: to foster the infrastructure of democracy, the system of a free press, unions, political parties, universities, which allows a people to choose their own way to develop their own culture, to reconcile their own differences through peaceful means.”<sup>4</sup>

The Honorable Dante Fascell, the then Democratic congressman from Florida and Chairman of the House Foreign Affairs Subcommittee on International Operations, was among the most vocal advocates of creating such a program. He was instrumental in initiating debates on Capitol Hill on how to best support democratic development – and he was not alone. William Brock, U.S. Trade Representative and former Republican National Committee Chairman, and Charles Manatt, Democratic National Committee Chairman, realized that the U.S. political parties had no platform for an international outreach similar to the German model. Brock noted, “Until recently our two political parties have done almost nothing to promote democracy abroad. (...) We should now seek to strengthen what President Reagan has called ‘the infrastructure of democracy’ – the network of private sector institutions within which democratic pluralism functions.”<sup>5</sup>

Politicians were not the only ones who recognized the need for a new approach to helping civil society organizations around the world devoted to democratic development in their countries. Lane Kirkland, president of the American Federation of Labor and Congress of Industrial Organizations, and Michael Samuels, vice president of the U.S. Chamber of Commerce’s International Division, also understood that greater international engagement with reform-minded labor and business organizations was needed as well. Samuels put it this way: “In functioning democracies, the private market system provides the economic growth and opportunity necessary for democratic stability. Where the market system of free choice among competing producers is abandoned, governmental authority soon comes to control an ever-increasing amount of everyday life. (...) Nor can closed political

systems provide as propitious an environment for private enterprise as democracy.”<sup>6</sup>

The “Democracy Program” study group was formed to translate that vision into an actionable proposal. The study group consisting of the representatives of the Democratic and Republican parties, labor, and the business community recommended the establishment of a bi-partisan, private, non-profit organization whose mission would be to strengthen democratic institutions around the world through non-governmental efforts. With this recommendation, the National Endowment for Democracy (NED) was formally created on November 18, 1983 by an act of Congress. Soon thereafter NED’s four core institutes were established: the American Center for International Labor Solidarity, the Center for International Private Enterprise, the International Republican Institute, and the National Democratic Institute.

## Building Market-Oriented Democracies

Democracy has two dimensions: leadership selection and decision-making. The dimension of leadership selection is where many of us in the democracy assistance community place the focus. Yet, democratic consolidation is not achieved simply through holding elections. Functioning democracies require opportunities for the public to provide input into the decision-making process *between* elections. If no such outlet exists, if the system of governance is not open and participatory, democracy will not deliver expected results.

In *The Spirit of Democracy*, Larry Diamond develops the idea of democratic decision-making: “The triumph of democracy and the march to prosperity are largely a story of taming [the] abuse of power, opening up access to political and economic markets, and binding the naturally predatory tendencies of rulers to impersonal, impartial rules and institutions.”<sup>7</sup> Therefore, functioning democracies and market economies are essentially two sides of the same coin: they both share the principles of transparency, accountability, fairness, and responsibility.

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“The ongoing worldwide economic crisis has brought a renewed interest in the DNA of a free market – transparency, accountability, and fairness. For the past 25 years, CIPE has championed these operating principles of private enterprise and democratic governance. (...) The business community can play a large part in stabilizing the world economy by instituting good governance practices, committing to transparency, and expanding opportunities for women and young people. At this time of heightened expectations, CIPE’s approach – which focuses on the nexus of democratic and economic reform – is as valid and important as it was when CIPE was established a quarter of a century ago. To have a sustainable economic system and ensure opportunities for long-term growth, countries must build market-oriented, democratic institutions.”

– Gregori Lebedev, CIPE Chairman of the Board and Senior Advisor at the Robertson Foundation *and* Thomas J. Donohue, CIPE President and President and CEO of the U.S. Chamber of Commerce

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There are three common myths that tend to obscure this symbiotic relationship between democracy and market economy. The first myth portrays business as a monolith. In reality, business communities in most countries are extremely diverse. They include small and medium-sized enterprises, the informal sector, leading-edge firms, crony firms, and state-owned companies. While state-connected companies with corrupt ties to the government fear the loss of their privileged position, the majority of businesses in any given country do want reforms. They want the same rules to apply to everybody. They want fewer barriers to conducting business. They want access to capital, technology, and export markets. These things are just not possible in a closed society, a closed economy, or a closed political system.

The second myth is that if a country has a private sector, it must automatically be a market economy. The term “market economy” is often used loosely, without analyzing what institutions must be in place for a market to work. Douglass North, winner of the 1993 Nobel Prize in economics, highlighted this crucial point by explaining the relationship between institutions and economic performance over time.<sup>8</sup> A market economy requires a complex institutional framework that goes beyond the presence of private enterprises. That framework cannot be developed in a vacuum: it is a result of

the political process that establishes the rules of the economic game through laws and regulations. Consequently, the development of key market principles such as property rights or the rule of law is in itself democratizing.

The third myth maintains that if only the government would get out of the way, the free market will emerge. However, this is not true. After the collapse of communism in Eastern Europe, some were of the opinion that it is enough to take the government out of the economy, to distribute state-owned property into private hands, and “the market” would take care of itself. Needless to say, that approach failed in Russia and many other post-Soviet countries where instead crony capitalists or oligarchs took control of the bulk of the economic assets and *de facto* control of the political system as well. The belief that removing government from the equation would solve the problem presumes the existence of underlying market institutions that are just not there in many developing countries.

CIPE’s objective has been to counter those three myths and to identify the elements within a given country’s private sector that are true forces of democratic and market-oriented change. Our partners are independent and reform-minded business associations, chambers of commerce, economic think tanks, and journalists. CIPE works with those partners to identify reform priorities, formulate policy solutions, overcome resistance to reforms, and build robust institutions that allow both democracies and market economies to flourish. Thus, the role of CIPE is not promoting private enterprise as such, but rather supporting the institutional infrastructure of democracies that deliver.<sup>9</sup> That is not an easy task as institution-building takes considerable time and effort. Yet, it is a necessary element of democratic development.

## The CIPE Business Model

CIPE works in four principal areas to help the business community become a leading advocate for democratic governance and market-oriented reform. These areas include: a grants program supporting grassroots networks in developing countries, capacity-building programs, and technical assistance through field offices.

Working with private sector organizations in developing countries is at the core of CIPE's business model. This implies that solutions to local problems can only be found through the grassroots engagement of local reformers. After all, local entrepreneurs know best which laws and regulations make it hard to do business in their countries – and how they can be improved. CIPE strives to give those reformers a voice through capacity building, advocacy training, and technical support. Program ideas and reform recommendations come from our partners. If they did not, they would lack the benefit of local knowledge, ownership, and support. We cannot assume why things work the way they do in a given country – but we can ask the right questions and assist reformers in rising to the challenges their countries face.

CIPE also works in partnership with other major international organizations. We worked with the Organisation for Economic Co-Operation and Development (OECD) to revise the OECD Principles of Corporate Governance, first released in 1999. A revision was published in 2004 that added new emphasis on ensuring the basis for an effective corporate governance framework, mirroring CIPE's efforts to build and support institutions that promote transparent, efficient markets and the rule of law. The greater goal of this and other such initiatives is to structure the principles of transparent and accountable business as an internationally recognized norm arrived at through the interactive dialogue engaging developing country voices.

CIPE provides a platform for that dialogue by working with an extensive network of partners in countries where there is both a need and an opportunity for reform. Even after a country or

a region disappears from the headlines, nascent reforms still need support to prevent them from being overturned at the first sign of difficulty. CIPE helps its partners become leaders in sustainable development initiatives. At the same time, CIPE also supports reformers in places where serious progress has yet to take place, recognizing that successes in one region may provide a model approach for another.

Another key element of CIPE's work is recognizing that just as businesses differ, not all business organizations are the same. In many countries, for instance, chambers of commerce rely on government-mandated membership. Such organizations tend to have little interest in pursuing reforms since they do not face the pressure to attract new members and they do not have to demonstrate clear benefits of membership. Reformers are more readily found among independent chambers of commerce and voluntary business associations, who tend more to have a vital interest in improving their country's institutional climate, and they strive to be creative in pursuit of reforms that benefit current and potential members.

## Key Themes of CIPE's Work

The very first person who walked through CIPE's doors was Hernando de Soto, President of the Institute for Liberty and Democracy (ILD) in Peru. In 1984, ILD received one of the first grants that CIPE ever made to work on the issues of the informal sector and access to property rights. De Soto went on to contribute invaluable to the world's understanding of the relationship between property rights and development. The key barrier to private sector growth, he has argued, lies in inadequate institutions. In his landmark book, *The Mystery of Capital*, he conservatively estimated that the total wealth held outside the formal legal system by the world's poor equaled forty times all foreign aid received since 1945.<sup>10</sup> It powerfully illustrated why poor property market institutions leave so many people in developing countries no choice other than to live and work in the informal sector.

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## The CIPE Business Model

- Empower private sector organizations
  - Promote institutional reform
  - Focus on advocacy
  - Reinforce local ownership and accountability
  - Apply lessons learned
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CIPE's work with Hernando de Soto inspired programmatic focus on the informal sector and property rights. Informality is a symptom of underlying institutional problems. In countries with large informal sectors, businesses are forced to operate outside of the protection and predictability of a legal framework, taxes are not paid, opportunities for corruption abound, and citizens are economically disenfranchised and unable to participate in policymaking. CIPE and its partners work to bring entrepreneurs into the formal economy where their voices can more easily be heard and where they can channel their talents and energy more productively.

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"Twenty-five years ago, I came to Washington, D.C., seeking support for the work of the Institute for Liberty and Democracy (ILD) in Peru, an organization I had recently founded. A colleague, who was aware of the newly created National Endowment for Democracy and the mission of its core institute the Center for International Private Enterprise (CIPE), suggested that I contact CIPE as there seemed to be a certain harmony between our goals. (...) CIPE understood why we were working with the informal economy, because even at its founding, CIPE was in touch with the emerging-market perspective, and offered its skills and long-term vision for creating democratic, market-oriented solutions. This value added by CIPE – an approach and staff imbued with the perspectives of history, culture, politics, and of course economics – was invaluable to ILD's growth and success."

– Hernando de Soto, President, Institute for Liberty and Democracy

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With associations as the primary vehicle for CIPE's work, developing the capacity of business associations, especially with regard to advocacy, was CIPE's early thematic focus. CIPE developed a number of successful advocacy training programs and approaches to support democratic and market-oriented reforms around the world. CIPE adapted the U.S. Chamber of Commerce's national business agenda (NBA) model to the needs of local partners in developing countries. An NBA is a tool for the business community to identify policy priorities and formulate concrete solutions. It aims to encourage investment and stimulate business activity and economic growth, and it creates a platform for public-private dialogue that improves democratic

governance. CIPE also uses the U.S. Chamber's Institute for Organization Management as a model for training programs overseas, benefiting executives and volunteers in business associations, chambers of commerce, employers' associations, and other types of private, membership-based organizations.

CIPE's interest in anti-corruption reform was also an early one, not only in its work with local partners but also with other international organizations. CIPE has worked with the World Bank Institute (WBI) on practical tools and guidelines for businesses committed to fighting corruption. Recently, WBI, CIPE, and other stakeholders in the business and non-governmental organization community jointly developed an Internet portal<sup>11</sup> exploring the constructive role business can play in fighting corruption and how this can be done through collective action. Although it is difficult, or nearly impossible, for an individual company to change a corrupt business environment, collective action among various stakeholders – including governments, companies, and civil society – can increase the effect they have on corrupt practices and bring tangible results.

Corporate governance first appeared in CIPE programs during the transition to democracy and a market economy in Eastern Europe after the fall of the Berlin Wall. The privatization process was getting under way throughout the region, but new owners lacked proper knowledge on how to run a company in a market environment, which often led to basic governance failures. The focus on corporate governance became even sharper after the 1997 Asian financial crisis and the 1998 Russian ruble crisis.

CIPE has also been working extensively on corporate governance issues in the Middle East. Until recently, there was no single term in Arabic for corporate governance; business leaders would either have to say it in English or use one of several imprecise Arabic words. During the first-ever corporate governance conference in Egypt, (organized in 2001 in Cairo by CIPE and local CIPE partners) Dr. Youssef Boutros Ghali, then minister of foreign trade recognized that the lack of

the equivalent Arabic term presented a serious problem. In cooperation with CIPE and local stakeholders, he supported the formation of a committee of experts to develop that term. After much deliberation, and with the approval by the Arabic Linguistic Council, *hawkamah ash-sharikat*, literally “the governance of companies,” was created as the new Arabic term for corporate governance.

CIPE also supports local efforts to expand the scope and quality of information available to decision-makers, businesses, and the public through improving the skills of journalists, supporting independent publications and media programs, and promoting greater access to information. CIPE strives to increase the participation of women and youth in policymaking and in the economy. Our approach is to provide these often underrepresented groups with tools to become effective leaders, entrepreneurs, and reformers. For instance, we work with women entrepreneurs and women’s business associations around the world that have been successful in removing traditional social and political barriers to women’s participation in the economies of countries such as Pakistan and Bangladesh,<sup>12</sup> as well as others.

The crucial theme underlying all CIPE programs is democratic governance. It is the key to successful democracies and market economies and comprises institutions and processes that determine how government decisions are made on a daily basis. Good governance requires mechanisms of accountability and information-sharing that have broad support and encourage active civic engagement. While vital institutions cannot be built overnight, the long-term payoff is a sustainable system that guards the rights of every citizen and opens the door to economic growth and opportunity. The CIPE Development Institute is a recently launched, free, online educational tool, capturing the key areas of CIPE’s work and explaining them in simple terms to diverse audiences around the world.<sup>13</sup> The institute features presentations by CIPE partners and renowned scholars, including Hernando de Soto, Douglass North, and Larry Diamond, attracting growing international audience.

CIPE continues to evolve and expand the scope of its work in order to ensure that it is timely, effective, and responsive to our partners’ needs and to larger global issues. One such issue gaining prominence in recent years is corporate citizenship. In light of corporate accounting scandals and the current financial crisis, the need to take a closer look at the roles and responsibilities of businesses became evident. As emerging markets are rising to global prominence, proper understanding of those roles and responsibilities by multinational corporations and local businesses alike is of great importance. CIPE emphasizes that good corporate citizenship must go beyond philanthropy, to become an integral part of each company’s business strategy, and ultimately help countries build better economic environments.

To enhance that understanding of corporate citizenship and its role in development, CIPE is currently developing *Corporate Citizenship Trends*, a website that will feature articles explaining this concept as well as success stories from around the world. As the debate on how to engage the billions of people in need of support heats up, CIPE maintains that out of many important development issues, none is more important than the role of the private sector. The hidden potential of development lies in the ability of the private sector to help countries create institutional systems that improve governance, curb corruption, and provide opportunities for entrepreneurship.<sup>14</sup>

## CIPE’s Role Then and Now

At the White House ceremony celebrating the establishment of the NED on December 16, 1983 President Reagan said, “There’s no simple cookbook recipe for political development that is right for all people, and there’s no timetable. While democratic principles and basic institutions are universal, democratic development must take into account historic, cultural, and social conditions. Each nation, each movement will find its own route.”<sup>15</sup> CIPE strives to do precisely that: to address development from developing countries’ perspective. CIPE has made the case over the years that building market institutions, fighting corruption, and improving

corporate governance are vital elements of political development and that argument has withstood the changing tides of history.

CIPE has lived through three distinct eras and may be entering a fourth in the larger global context of democratic development. The first era, from 1984 to 1989, was Huntington's third wave of democratization when democracy swept across Latin America and Southeast Asia. The second period started with the fall of the Berlin Wall. It marked the beginning of a transition to democracy in Eastern Europe, creating new challenges for CIPE. With the collapse of communism some began to question the necessity for the NED's – and CIPE's – continued work. CIPE's answer was that introducing elections is just a first step in building the institutions of democracy. In and of themselves elections may be a great success, but they are not enough to ensure that new and fragile democracies survive and develop functioning market economies. There was still plenty of work to be done in terms of institution building.

The third era was the post-9/11 world, with increased focus on reforms and reconstruction in conflict-affected Afghanistan, Iraq, and other areas. Currently, we are entering a fourth period marked by what Larry Diamond has called a democratic recession. Countries that were stable democracies – or at least were thought to be – began moving in the other direction. In Latin America, examples include Venezuela, Bolivia, and Ecuador to some extent. Democratic setbacks are evident in Africa as well, notably with Robert Mugabe's iron grip over Zimbabwe and electoral violence in Kenya in late 2007. These setbacks are often accompanied by the breakdown of market institutions and rapid economic declines.

Douglass North pinned down the whole history of economic growth in the following explanation: economic history is about evolving from purely personal exchanges, where one can only do business with friends and family because they are the only ones that can be trusted, to the ability to contract with strangers: buy land, sell goods and services, and borrow money.<sup>16</sup> Being able to do these things

with a complete stranger is what makes a modern market economy, and the institutions that a country needs to build in order to enable impersonal exchange are what improving economic performance is all about.

It is important to remember that a crucial part of this process is democratic governance. North talks about adaptive efficiency, or the degree to which institutions can adapt to change. Being open to change and trying out new solutions and ideas is the hallmark of liberal democracy. Without allocative efficiency, or the ability of the economy to allocate goods and resources to their most efficient use, sustained economic growth is not possible. Similarly, no system other than democracy can guarantee the political and economic freedoms necessary to make adaptation to change possible. It is this adaptive efficiency of democracy that enables transition from barter to markets – and consequently sustained growth and development.

As CIPE approaches the quarter-century mark, the issue of sustainability remains a chief concern. Work to create lasting reforms does not end with a passage of a new law or an amendment of a regulation. In fact, the work often begins there. Reforms are not about any single event so much as about a cumulative process of incremental change through which institutions that guarantee transparency, accountability, fairness, and responsibility are built into political and economic systems of countries and take root in the hearts and minds of their citizens.

## A Look Ahead

On June 7, 2007 NED President Carl Gershman donated NED's founding papers to the Library of Congress to mark the anniversary of President Reagan's Westminster Speech. Among the featured speakers on the panel discussion during the commemorative ceremony was Thomas Carothers, vice president for studies at the Carnegie Endowment for International Peace, who remarked that during 25 years of the work of the NED and its core institutes "probably hundreds of thousands of people around the world have been directly

touched by democracy assistance programs in ways that have given them knowledge, understanding, moral support, inspiration, and solidarity.”<sup>17</sup> For its part, CIPE has worked in nearly 100 countries with more than 450 organizations, building a network of partners around the world committed to democratic and market-oriented reforms.

CIPE's partners in success are many,<sup>18</sup> but some recent events are especially worth noting. In Ghana, the Institute for Economic Affairs (IEA) made significant contributions to last year's free and peaceful elections by organizing a number of pre-election debates and obtaining a commitment from political parties to strictly adhere to the campaign code of conduct. In Pakistan, CIPE worked to revise the law to allow women to independently form chambers of commerce and in 2008, the first two such organizations were registered. In Montenegro, CIPE partners successfully advocated for a new 9 percent flat income tax rate that has made the country attractive to investors. In Azerbaijan, a new, single-window registration system has simplified procedures for starting a business. In Guatemala, taxes on land transfers and other fixed assets was significantly reduced in response to business community advocacy. In Tunisia, a new Finance Law harmonized taxation rules with accounting practices, strengthening transparency.

Such advancements in democratic and market-oriented reforms are certainly not to be overlooked. Yet, complacency and past achievements alone are not reason enough for CIPE's continued existence. In this age of new challenges to democracy and economic uncertainty around the world, CIPE itself must remain an example of adaptive efficiency when working on its core issues if it seeks to advance globally. Each day presents new ways of fostering institutions necessary to sustain market-oriented democracies and to increase private sector participation in the democratic process. Advocacy continues to be at the center of CIPE programs as partners work to consolidate local support for representative policymaking and stimulate debate on reforms. Going forward, CIPE is ready to address new challenges and will continue to seek new and innovative ways in which to augment grassroots-driven reform efforts around the globe.

## Notes

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- <sup>18</sup> See CIPE 2008 Annual Report for more details, available at [www.cipe.org/about/report/index.php](http://www.cipe.org/about/report/index.php)

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*The Center for International Private Enterprise (CIPE) strengthens democracy around the globe through private enterprise and market-oriented reform. CIPE is one of the four core institutes of the National Endowment for Democracy and a non-profit affiliate of the U.S. Chamber of Commerce. For 25 years, CIPE has worked with business leaders, policymakers, and journalists to build the civic institutions vital to a democratic society. CIPE's key program areas include anti-corruption, advocacy, business associations, corporate governance, democratic governance, access to information, the informal sector and property rights, and women and youth.*