

## Articles

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### RMDs

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Redistributive models of democracy (RMD), to use Haggard and Kaufman's expression, have been criticized on several counts: (1) their empirical performance is weak; (2) they make *unconditional* predictions about the relationship between structural variables (inequality, asset specificity, organizational and information parameters) and political transitions; and (3) the parameters of the models are either too narrow and stylized or simply wrong – particularly (a) the assumption of rational, self-interested actors motivated by material interests, (b) the definition of 'classes', (c) the sequence of the political decision process, and (d) the tax setting model. After examining these critiques briefly here, I conclude that, broadly speaking, the idea of democracy as an equilibrium (given by the material payoffs of relevant social and economic actors) is: (1) relatively robust and (2) the best point of departure (or, in Lakatos' terms, a core) from which to progressively build a satisfactory theory of political transitions.

#### Empirical Performance of the Theory

Several important empirical tests on RMD find that the association between economic inequality, asset specificity and political transitions either does not exist, is highly unstable or is restricted to democratic breakdowns. Houle (2009) concludes that inequality makes democratic breakdowns more likely but does not affect democratic transitions after 1960. Ansell and Samuels (2010) find that land inequality explains democratic transitions since the mid-19th century but that income inequality has the opposite effect. Haggard and Kaufman (2012) claim that almost half of all political transitions since 1980 are unrelated to distributive conflict.

As I have insisted elsewhere,<sup>1</sup> the examination of the covariates of political transitions has to be systematic to the point of including all the

1. Christian Houle, "Inequality and Democracy: Why Inequality Harms Consolidation but Does not Affect Democratization," *World Politics* 61 (October 2009): 589-622; Ben Ansell and David Samuels, "Inequality and Democratization: A Contractarian Approach," *Comparative Political Studies* 43 (December 2010): 1543-1574; Stephan Haggard and Robert R. Kaufman, "Inequality and Regime Change: Democratic Transitions and the Stability of Democratic Rule," *American Political Science Review* 106

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## DEMOCRACY, PUBLIC POLICY AND INEQUALITY

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The relationship between inequality and democracy has been theorized since at least Aristotle, but in the last decade it has been subject to intense theoretical and empirical investigation. The first formal models of democratic transitions by Acemoglu and Robinson (2000, 2001) suggested that there would be an inverse U-shaped relationship between inequality and democratization. Autocracies that were too equal would not democratize because there would not be enough social conflict to create an effective demand for changes in political institutions. Autocracies that were too unequal would not democratize either because democratization would be very costly for non-democratic elites who would attempt to stay in power via repression. These models also predicted that democratization itself ought to reduce inequality as the newly enfranchised would vote for redistribution and more active government policy.

These theoretical results were obviously conditional on key modeling decisions. For one, political conflict was conceived of as rich/elite versus poor/citizen with autocracy being associated with rule by the elite and democratization being associated with a transfer of power from rich to poor with a resulting change in policy from pro-elite to pro-poor. Though this set-up has a parsimonious appeal, the comparative statics are conditional on some very simple models of both types of political regime. For example, Acemoglu and Robinson (2006) showed that once one relaxed the simple poor versus rich nature of political conflict in their original models as well as the restriction of policy instruments, the nature of the comparative statics with respect to inequality in the basic model changed.<sup>1</sup> Put simply, if the groups in conflict were not

1. Daron Acemoglu, and James A. Robinson, "Why Did the West Extend the Franchise? Growth, Inequality and Democracy in Historical Perspective," *Quarterly Journal of Economics* 115 (2000): 1167-1199; Daron Acemoglu and James A. Robinson, "A Theory of Political Transitions," *American Economic Review* 91 (September 2001): 938-963; Daron Acemoglu and James A. Robinson, *Economic Origins of Dictatorship and Democracy* (New York: Cambridge University Press, 2006).

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rich versus poor, but for example based on ethnic, religious or regional cleavages, it was not necessarily true that increasing inequality, in the sense of a higher Gini coefficient, would exacerbate conflict between groups. It might just result in increased redistribution within groups. More generally, though there is now convincing econometric evidence for the importance of the central mechanisms of Acemoglu and Robinson's early work,<sup>2</sup> still, as emphasized by Haggard and Kaufman (2012), there may be different mechanisms that lead to democratization and these can have different comparative statics from those presented in Acemoglu and Robinson (2000, 2001). For instance, in Lizzeri and Persico (2004) democratization can occur because political competition with a limited franchise leads to clientelistic outcomes that are inefficient for at least a sub-set of the elite.<sup>3</sup> Extending voting rights can induce more efficient non-clientelistic competition over public goods that is favored by these elites. Depending on the decision structure within elites, democratization can occur for very different reasons than those developed by Acemoglu and Robinson.<sup>4</sup>

These theoretical extensions of the basic model suggested that it was unlikely that the simple comparative statics of inequality suggested by the early work would be found in the data. Moreover, even if one found these in a convincing way one would

2. See for instance in Toke S. Aidt and Peter S. Jensen, "Workers of the World Unite! Franchise Extension and the Threat of Revolution in Europe, 1820-1938," <http://www.econ.cam.ac.uk/faculty/aidt/papers/web/workers/workers.pdf>, 2012.

3. Stephan Haggard and Robert R. Kaufman, "Inequality and Regime Change: Democratic Transitions and the Stability of Democratic Rule," *American Political Science Review* 106 (August 2012): 495-516; Alessandro Lizzeri and Nicola Persico, "Why Did the Elites Extend the Suffrage? Democracy and the Scope of Government, with an Application to Britain's Age of Reform," *Quarterly Journal of Economics* 119 (2004): 707-765.

4. See also Humberto Llavador and Robert J. Oxoby, "Partisan Competition, Growth, and the Franchise," *Quarterly Journal of Economics* 120 (2005): 1155-1192.

have to deal with complicated issues of identification. For example, autocracies which were unequal no doubt differ in many others ways from autocracies which are equal, and to test causal hypotheses about the impact of inequality on regime transition it is necessary to control in some way for these omitted variables. It is also necessary to control properly for common trends influencing the variables to avoid the problem of 'spurious regression'. Since democracy tends to move in waves and many other variables such as GDP per-capita are correlated across countries, this is a potent issue here.

Since this early work a great deal of research has gone into investigating empirically the factors that lead to democratization and democratic consolidation. In largely unpublished work which accompanied Acemoglu et al. (2008, 2009),<sup>5</sup> the authors found no robust evidence that inequality influences either democratizations or democratic consolidation. The innovation of this empirical work is that it adopted for the first time standard panel data econometric techniques to control for omitted variables with country fixed effects and common trends with time effects. The importance of the fixed effects methodology is that it focuses on the 'within variation' and asks, in this context: as a country becomes more or less unequal, does that induce changes in the extent to which it is democratic? By focusing on this variation one mitigates the biases than come from examining the cross-sectional (between) variation that is mired in unobservable differences between countries. The importance of the inclusion of time effects is that they control for common trends amongst the variables mitigating the danger of spurious

5. Daron Acemoglu, Simon Johnson, James A. Robinson, and Pierre Yared, "Income and Democracy," *American Economic Review* 98 (June 2008): 808-842; Daron Acemoglu, Simon Johnson, James A. Robinson, and Pierre Yared, "Reevaluating the Modernization Hypothesis," *Journal of Monetary Economics* 56 (November 2009): 1043-1058. See, however, Table 5 in this essay.

regression. The empirical work of Acemoglu et al. showed that some of the most famous empirical results in the literature, such as the correlation between income per-capita and democratic consolidation, were not robust to controlling for omitted variables. This paper went even further than fixed effects models by providing a full identification strategy using instrumental variables, an exercise that confirmed the basic fixed effects findings. This project also revealed that there was no robust relationship between inequality and either the creation or consolidation of democracy.

Other studies have since found different things, but to do so they have deviated from the econometric approach of Acemoglu et al in significant ways. For example, Epstein et al. (2006) presented evidence that was consistent with the inverted-U shape hypothesis of Acemoglu and Robinson (2001). Houle (2009) found that while inequality has no impact on democratization, higher inequality reduces the probability that a democracy will stay democratic. Yet neither paper made any attempt to control for omitted variable bias, for example using country fixed effects. Therefore, it is quite likely that these findings are driven by omitted variables and thus do not represent causal relationships between inequality and regime transition. Freeman and Quinn (2012) moved beyond studies of the average effect of inequality on regime transitions investigating whether or not there are heterogeneous effects of inequality that depend on the extent of globalization.<sup>6</sup> They do claim to find robust effects of inequality on the change in the polity score, the sign of which is

6. David L. Epstein, Robert Bates, Jack Goldstone, Ida Kristensen, and Sharyn O'Halloran, "Democratic Transitions," *American Journal of Political Science* 50 (July 2006): 551-69; Christian Houle, "Inequality and Democracy: Why Inequality Harms Consolidation but Does Not Affect Democratization," *World Politics* 61 (October 2009): 589-622; John R. Freeman and Dennis P. Quinn, "The Economic Origins of Democracy Reconsidered," *American Political Science Review* 106 (February 2012): 58-80.

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conditional on measures of globalization. Yet, their preferred specification does not include time effects to account for common trending factors, an omission which Acemoglu et. al. (2009) showed is highly significant in this context, given that democracy tends to trend at the world level. Their paper also uses software to interpolate missing inequality data, a procedure that tends to artificially lower the standard errors of their estimations, which also pushes them towards finding significant effects. The omission of time effects is a common feature of papers that claim to find significant effects of measures on inequality on measures of democracy.<sup>7</sup>

We believe therefore that the basic though unfortunately largely unpublished findings of the Acemoglu, et. al. (2008, 2009) project, that there is no robust causal relationship between inequality and regime transition, remain substantially unaltered.

This analysis still leaves open one interesting empirical question latent in Acemoglu and Robinson (2000, 2001) and indeed in Meltzer and Richard (1981). Does democratization tend to reduce inequality? A seminal paper by Rodrik (1999) claimed that it did and that the share of wages in national income was systematically higher in democracies. But a prior question would be: does democratization have in reality the type of impact on public policy that it does in these models? One much cited paper, by Gil, Mulligan and Sala-i-Martin (2004) claimed in fact that there was no significant relationship between measures of democracy, such as the Polity score, and public policy variables such as the size of government tax revenues relative to GDP, or the amount of social spending relative to GDP. Yet their paper used averaged data to examine the pure cross-sectional relationships in the data. This setup creates severe concerns both about measurement error (from the averaging) and omitted

7. For example Ben Ansell and David Samuels, "Inequality and Democratization: A Contractarian Approach," *Comparative Political Studies* 43(December 2010): 1543-74.

variable bias. In particular, their procedure meant that they could not examine the more interesting 'within variation' through examining whether or not when a country democratized, or the reverse, public policies moved in specific directions.

In Acemoglu et al. (2013) we examine the impact of democratization on public policies and inequality using the most appealing econometric model - a cross-national panel data with country fixed effects and time effects.<sup>8</sup> Our study uses a theoretical framework that recognizes that the simple predictions of Meltzer and Richard (1981) and Acemoglu and Robinson (2000, 2001), that democratization decreases inequality may be influenced by mechanisms this research did not consider. This happens for some of the same reasons we discussed above when we argued that the impact of inequality on democratization is likely more complex than the initial models allowed for, but in addition we make several specific arguments.

1. *Captured Democracy.* Even though democracy clearly changes the distribution of de jure power in society (as argued, for instance, in Acemoglu and Robinson, 2006), policy outcomes and inequality depend not just on the de jure but also on the de facto distribution of power. Acemoglu and Robinson (2008) argue that, under certain circumstances, those who see their de jure power eroded by democratization may sufficiently increase their investments in de facto power (e.g., via control of local law enforcement, mobilization of non-state

8. Allan M. Meltzer and Scott F. Richard, "A Rational Theory of the Size of Government," *Journal of Political Economy* 89 (October 1981): 914-927; Dani Rodrik, "Democracies Pay Higher Wages," *Quarterly Journal of Economics* 114 (1999): 707-738; Ricard Gil, Casey B. Mulligan, and Xavier Sala-i-Martin (2004) "Do Democracies Have Different Public Policies than Nondemocracies?" *Journal of Economic Perspectives* 18 (Winter 2004): 51-74; Daron Acemoglu, Suresh Naidu, Pascual Restrepo, and James A. Robinson, "Democracy, Inequality and Public Policy," forthcoming in Anthony B. Atkinson and François Bourguignon, eds., *The Handbook of Income Distribution* (Amsterdam, North-Holland, 2013).

armed actors, violence, lobbying, and other means of capturing the party system) in order to continue to control the political process. If so, we would not see an impact of democratization on public policy, redistribution and inequality.

2. *Directors Law.* Consistent with Stigler's 'Director's Law' (1970), democracy may transfer political power to the middle class rather than the poor. If so, redistribution may increase and inequality may be curtailed only if the middle class is in favor of such redistribution. For example, Aidt et al. (2009) showed that local franchise expansion in 19th century Britain from elites to the middle class often reduced expenditure on local public goods since the middle class bore the brunt of property taxes that financed them. In their model an expansion of voting rights from the elite, by reducing public good provision and taxes on the middle class, can increase inequality.<sup>9</sup>

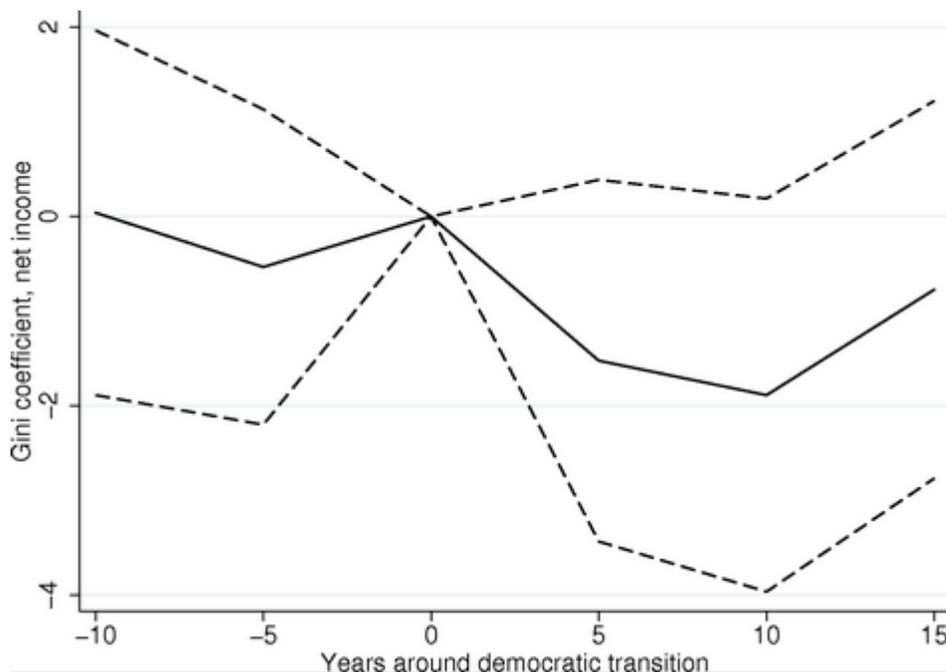
3. *Inequality-Increasing Market Opportunities.* Autocracy may exclude a large fraction of the population from productive occupations (e.g., skilled occupations) and entrepreneurship (including lucrative contracts), as Apartheid South Africa or the former Soviet Union did both internally and in Eastern Europe after 1945. To the extent that there is significant heterogeneity within this population, the freedom to take part in economic activities on a more level playing field with the previous elite may actually increase inequality within the excluded or repressed group and the entire society. It may also lead changes in public policy

9. Daron Acemoglu and James A. Robinson, "Persistence of Power, Elites and Institutions," *American Economic Review* 98 (March 2008): 267-293; George J. Stigler, "Director's Law of Public Income Redistribution," *Journal of Law and Economics* 13 (April 1970): 1-10; Toke S. Aidt, Martin J. Daunton, and Jaysri Dutta, "The Retrenchment Hypothesis and the Extension of the Franchise in England and Wales," *The Economic Journal* 120 (September 2010): 990-1020.



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**Figure 3. Change in the Gini coefficient for net income between 1975 and 2000, against the change in the Freedom House democracy index in the same period.**



increases over time (eventually reaching 5%). By 15 years after a democratization the standard error bands exclude zero.

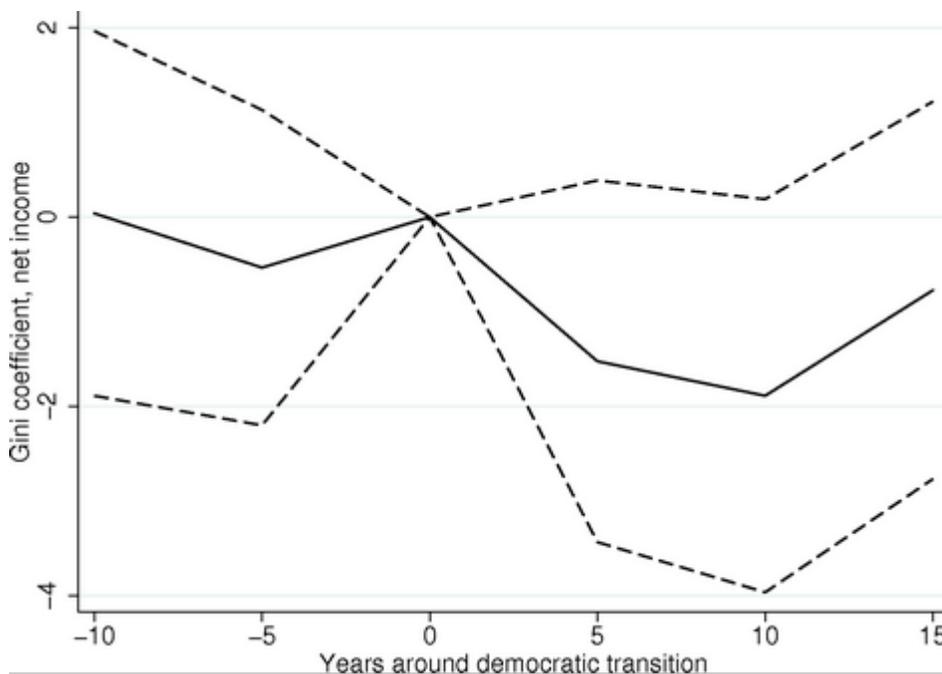
Second, however, and contrary to Rodrik (1999), we find no robust effect of democracy on any measure of inequality. Even though some selected specifications do show a small, marginally significant effect, these are not robust. This may reflect the poorer quality of inequality data. But we also suspect it may be related to the more complex theoretical relationships between democracy and inequality pointed out above. The absence of a relationship between the changes in democracy (Freedom House) and the change in the Gini coefficient 1975-200 is evident from Figure 3. Figure 4 is an analogous event-study figure. It shows that after a democratization there does seem to be a fall in inequality but it is not statistically distinguishable from zero.

Revisiting Rodrik's findings we show that while his results do still hold with our measure of democracy (significant at the 7% level), they are driven by several important things. First of all, the fact that

he averaged the data, and second, that he used an old version of the World Bank data on wages. If instead of averaging the

data we use every five years, the standard approach with a dynamic panel, his main finding disappears. It also disappears even with his own specification when we use the more complete and updated version of the data on wages (which he did not have available at the time he wrote). Third, we find an effect of democracy on secondary schooling investments and the extent of structural transformation (e.g., an impact on the non-agricultural share of employment and the non-agricultural share of output). How could it be that democracy leads to higher taxes and more education and possibly structural change but has no impact on inequality? This is an issue that requires a great deal more research than in Acemoglu et al. (2013), but all three of the above mechanisms could be at play. The fact that policy clearly changes after democratization seems less consistent with ideas about captured democracy, though it could be that while elites cannot stop taxation, they can manipulate how it is spent. The findings do seem more consistent with Director's Law and Stigler's claim that democracy

**Figure 4. Gini coefficient for net income around a democratization.**



favors the middle class and therefore does not generate the type of pro-poor or pro-median voter policies hypothesized by the early theoretical work. It could also be the case that inequality increasing market opportunities are at work with taxation and redistribution taking place but their effect on inequality being swamped.

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