# THE POLITICAL ECONOMY OF LIBERAL DEMOCRACY (AND ITS ENEMIES)

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# Democracy has won …



Source: https://www.systemicpeace.org/polity/polity1.htm
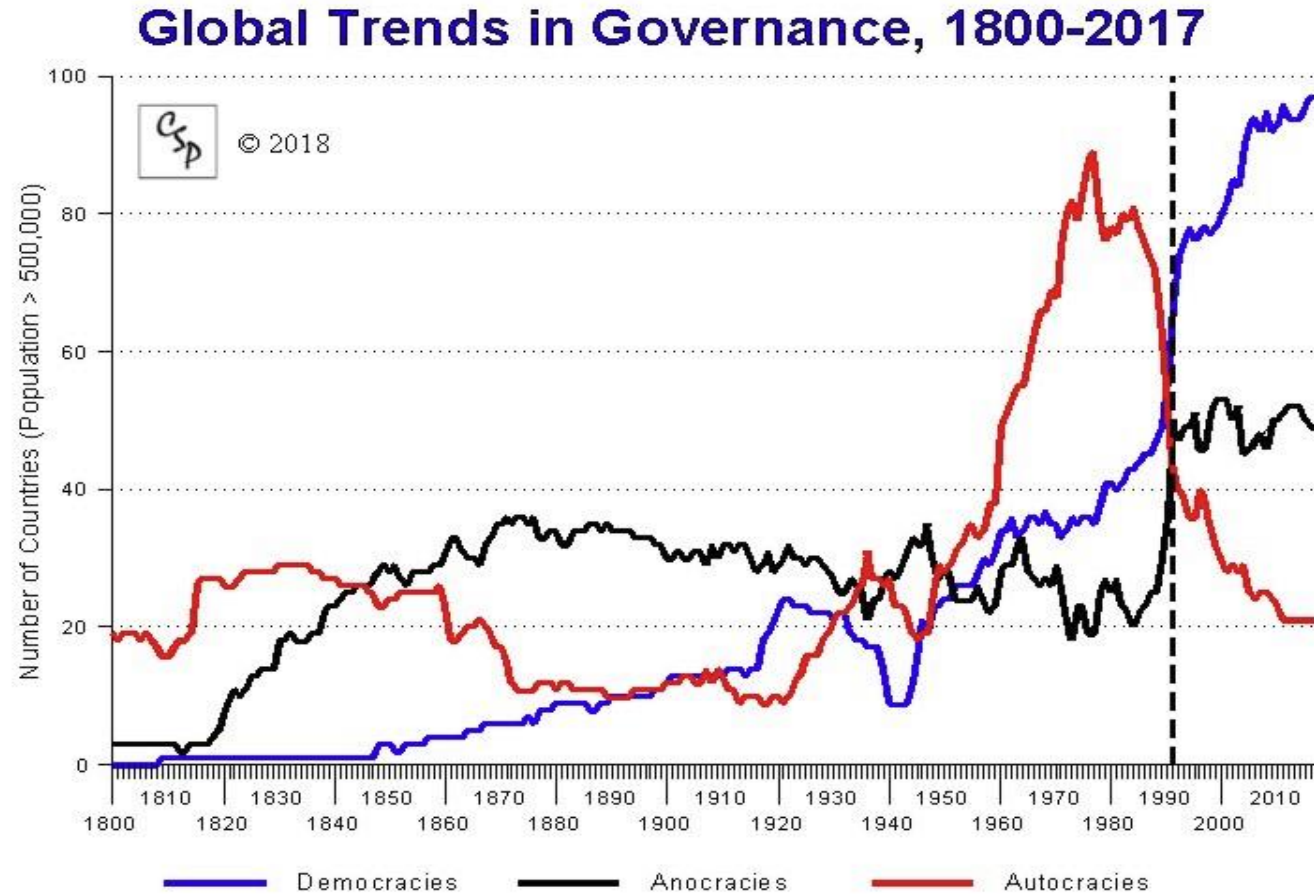
# But what kind of democracy?

- widespread rights violations
  - discrimination against minorities and opposition groups in many OECD countries: Hungary, Israel, Mexico, Turkey
  - much worse in countries like Russia and Venezuela
  - support for authoritarian populists in the U.S. and Western Europe
- even though elections remain in principle free and competitive
  - e.g., Turkey's presidential elections in May 2023
- preponderance of intermediate regimes
  - Fareed Zakaria: "illiberal democracy"
  - Steve Levitsky and Lucan Way (2010): "competitive authoritarianism"

# Retrogression in "Liberal" Democracy

**FIGURE 3.** LIBERAL DEMOCRACY BY COUNTRY AVERAGES AND POPULATION WEIGHTS, 1972–2022
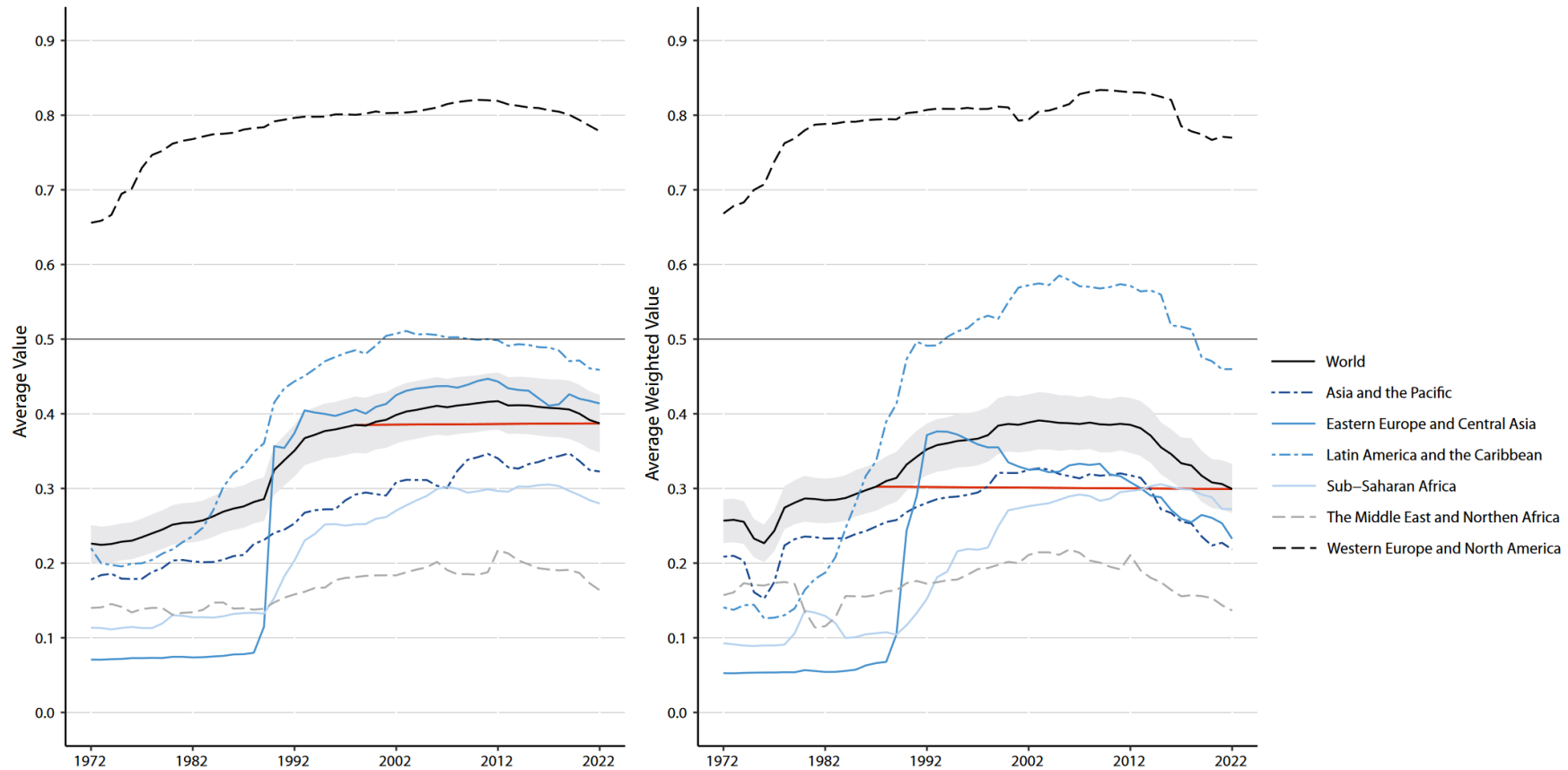


*The black lines represent global averages on the LDI with the grey area marking the confidence intervals. The left panel is based on conventional country averages. The right panel shows average levels of democracy weighted by population.*

Source: https://www.v-dem.net/documents/30/V-dem_democracyreport2023_highres.pdf

# What is liberal democracy: a taxonomy of rights

1. Property rights protect asset holders and investors
2. Political/electoral rights guarantee free and fair electoral contests and allow the winners of such contests to determine policy subject to the constraints established by other rights (when provided).
3. Civil rights ensure equality before the law – i.e. non-discrimination in the provision of public goods such as justice, security, education and health.
4. Social rights provide access to social welfare, education

- Illiberal democracies provide only electoral rights
- liberal democracies provide both electoral and civil rights

# Distribution of electoral and civil rights across countries
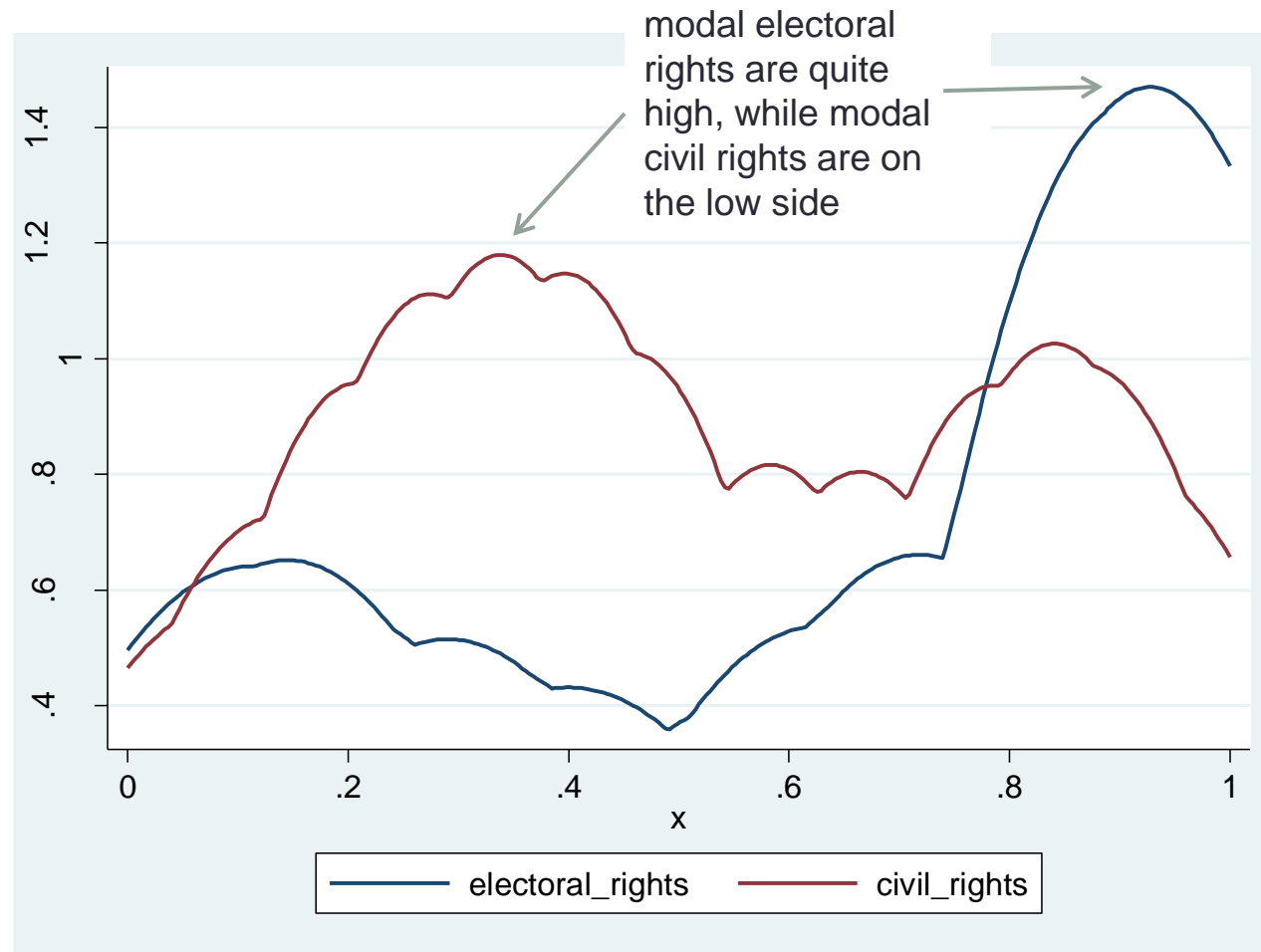


Source: Based on Freedom House raw scores for 196 countries. "Electoral rights" refer to free and fair elections (A1+A2); "civil rights" combine measures of independent judiciary (F1), rule of law (F2), and equal treatment (F4).

# A taxonomy of political regimes

| | | property rights | | | |
|---|---|---|---|---|---|
| | | no | | yes | |
| | | *political rights* | | *political rights* | |
| | | no | yes | no | Yes |
| *civil rights* | no | | | | |
| | yes | | | | |

# A taxonomy of political regimes

| | | property rights | | | |
|---|---|---|---|---|---|
| | | no | | yes | |
| | | political rights | | political rights | |
| | | no | yes | no | Yes |
| civil rights | no | | | (5)<br>right-wing autocracy | (6)<br>electoral/illiberal democracy |
| | yes | | | (7)<br>liberal autocracy | (8)<br>liberal democracy |

# A taxonomy of political regimes: illustrations

| | | property rights | | | |
|---|---|---|---|---|---|
| | | no | | yes | |
| | | political rights | | political rights | |
| | | no | yes | no | Yes |
| civil rights | no | | | (5) right-wing autocracy | (6) electoral/illiberal democracy Bolivia, Georgia, Turkey, Hungary,… (n=45) |
| | yes | | | (7) liberal autocracy Monaco (n=1) | (8) liberal democracy Canada, Chile, S. Korea, Uruguay,… (n=46) |

Source: Based on Freedom House raw scores for 196 countries in 2015. The cutoff for electoral and liberal democracies is 0.8 on a [0,1] scale of electoral and civil rights as defined earlier. "Electoral rights" refer to free and fair elections (A1+A2); "civil rights" combine measures of independent judiciary (F1), rule of law (F2), and equal treatment (F4). **Israel would have been classified as a liberal democracy based on 2015 scores.**

# The (instrumental) advantages of liberal democracy

- Liberal democracies
  - produce lower short-term instability
  - greater longer-term predictability
  - are better at handling external shocks
  - [produce higher rates of economic growth?]

- Causal channels
  - information aggregation
  - self-correction thru elections
  - social cooperation induced by deliberation, non-feasibility of expropriation, and repeated interaction among groups
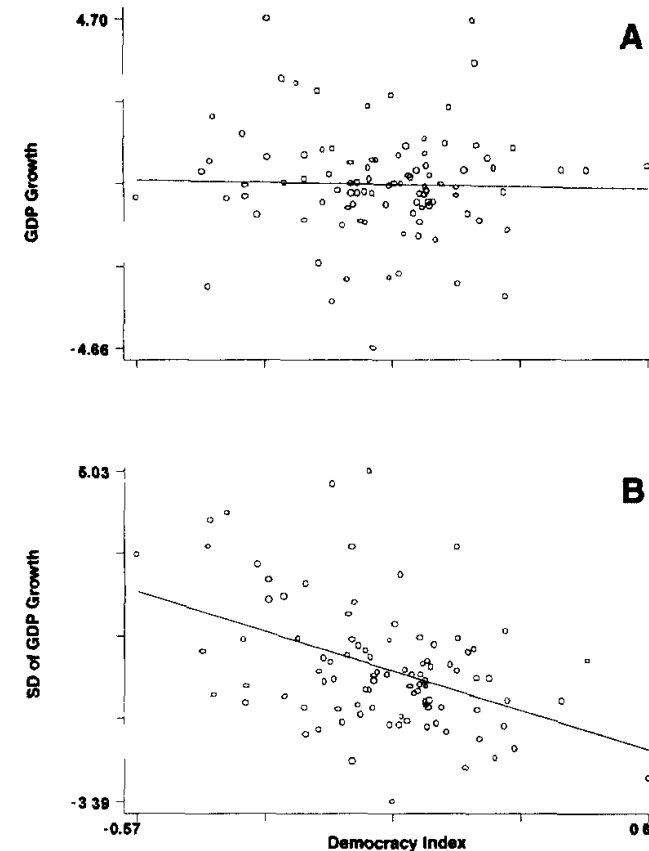


FIGURE 1. THE PARTIAL CORRELATION BETWEEN DEMOCRACY AND (A) GROWTH OF PER CAPITA GDP AND (B) THE STANDARD DEVIATION OF ANNUAL GROWTH RATES OF PER CAPITA GDP

Source: Rodrik (2000)

# Positive analysis: when is LD likely to emerge?

# Three groups in society

- A propertied elite, whose primary objective is to keep and accumulate their assets (property rights);
- A majority, who want electoral power so they can choose policies that improve their economic conditions (political rights);
- A minority (ethnic, linguistic, regional, ideological), who desire equality under the law and the right not to be discriminated against in jobs, education, etc. (civil rights).

Note the two cleavages;
- the income/class cleavage          (elite versus non-elite)
- the "identity" cleavage          (majority versus minority)

# An immediate result

- LD is an <u>unlikely</u> outcome of any "democratic settlement" between the elite (who have the resources) and the majority (who have the numbers)
  - so what's surprising is not how rare LD is, but that it exists at all
- Why this has been overlooked:
  - in political economy: tendency to focus on elite-non-elite cleavage
  - in history of liberalism: failure to ask why propertied elite should want to protect minority rights in addition to theirs (i.e., property rights), so conflation of property with civil rights

# More formal structure (1)

- members of each group $i \in [e, a, b]$ derive utility from their (after-tax) income $y_i$ and from consuming a public good $\pi_i$. $$u_i = y_i + \pi_i.$$
- pre-tax/transfer shares of the elite and non-elite given by $\alpha$ and (1-$\alpha$), respectively.
- elite constitute a negligible share of the population but control more than half of pre-tax/transfer output ($\alpha > \frac{1}{2}$).
- non-elite are split between a majority and a minority, with population shares *n* and (1-*n*), respectively (*n* $> \frac{1}{2}$).
    - gap between $\alpha$ and $\frac{1}{2}$ is a measure of the class (income) cleavage.

# More formal structure (2)

- we model the identity cleavage by assuming groups exhibit differences in the type of public good they prefer.
  - type of public goods is indexed by $\theta \in [0,1]$
  - three groups' ideal types are given by $\theta_i$, $i \in [e, a, b]$
- the deadweight loss associated with the provision of public goods increases with the level of expenditures and the gap (from the perspective of each group) between the type that is provided and the preferred type.
- denoting total expenditure on the public good by $r$, the utility derived from the public good is thus expressed as

$$\pi_i = r - \{1 + |\theta_i - \theta|\}\frac{\gamma}{2}r^2$$

- we normalize the majority's preferred public good by taking $\theta_a = 1$.

# More formal structure (3)

- the political regime determines
    - (i) how the public good is financed (whether through general taxation or the extraction of a surplus from the non-elite),
    - (ii) the level of expenditures on the public good, and
    - (iii) the type of public good provided.
- in right-wing autocracy (RA), the elite make all these decisions
- in liberal autocracy (LA), the elite remain in the driving seat, but they cannot discriminate against any particular group in taxation or the nature of public good
- in electoral democracy (ED), the majority selects an economy-wide tax rate and chooses the type of public good, disregarding the minority's wishes completely.
- in liberal democracy (LD), the majority retains control over the tax rate, but they cannot discriminate against the minority.
    - so they must provide a public good which lies somewhere in between the majority and minority's ideal types

# ED versus LD: nature of public goods

| | | political rights | |
|---|---|---|---|
| | | no | yes |
| civil rights | no | (5) right-wing autocracy (RA) $\sigma^{RA} = \dfrac{1}{\gamma(1-\alpha)}$ $\theta = \theta_e$ | (6) electoral democracy (ED) $\tau^{ED} = \dfrac{\alpha}{\gamma}$ $\theta = \theta_a = 1$ |
| | yes | (7) liberal autocracy (LA) $t^{LA} = \dfrac{1-\alpha}{\gamma}$ $\theta = \bar{\theta}$, with $\theta_b < \bar{\theta} < 1$ | (8) liberal democracy (LD) $\tau^{LD} = \dfrac{\alpha}{\gamma(2-\bar{\theta})}$ $\theta = \bar{\theta}$, with $\theta_b < \bar{\theta} < 1$ |

# ED versus LD: taxes

| | | political rights | |
|---|---|---|---|
| | | no | yes |
| *civil rights* | no | (5) right-wing autocracy (RA) $\sigma^{RA} = \dfrac{1}{\gamma(1-\alpha)}$ $\theta = \theta_e$ | (6) electoral democracy (ED) $\tau^{ED} = \dfrac{\alpha}{\gamma}$ $\theta = \theta_a = 1$ |
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$\tau^{ED} \geq \tau^{LD}$ since $\bar{\theta} \leq 1$

# Payoffs to groups in LD versus ED

- Majority: $u_a^{LD} < u_a^{ED}$ (unambiguous) *worse off*
- Minority: $u_b^{LD} > u_b^{ED}$ (unambiguous) *better off*
- Elite: $u_e^{LD} > u_e^{ED}$ if elites share identity with minority (e.g., $\theta_e \approx 0$)

  $u_e^{LD} < u_e^{ED}$ if elites share identity with majority ($\theta_e \approx 1$) and income/class cleavage not too deep ($\frac{1}{2} < \alpha < \frac{2}{3}$)

  *worse off unless elites share identity with minority,*

  *or income/class cleavage is too deep*

# A specific game

- status quo: Right-wing Autocracy (RA)
- shock makes RA unsustainable, in the sense that expected utility to majority from revolution exceeds utility under RA, i.e. $u_a^{RA}(=u_b^{RA}) < \rho u_a^{DP}(=\rho u_b^{DP})$

  [$\rho$ is probability revolution succeeds; otherwise majority gets payoff of 0]
- elite move first and offer a regime in the set $\{LA, ED, LD\}$
- majority move next, and they either accept the regime offered, or they mount a revolution
- finally, minority move last, and they decide either to join the revolution or to stay put

# Results

- The parameter space under which *ED* emerges is larger than (and encompasses) the parameter space under which *LD* emerges.
  - *Proposition 1. There exist parameter combinations under which ED will emerge and LD will not. The reverse is not true.*

- LD requires quite special circumstances: mild levels of income inequality as well as weak identity cleavages.
  - despite the fact that elites have "agenda-setting" power because they move first

- When the class or the identity cleavage is large, either the elite or the majority (or both) prefer alternative political regimes, and the prospects of LD are thwarted.
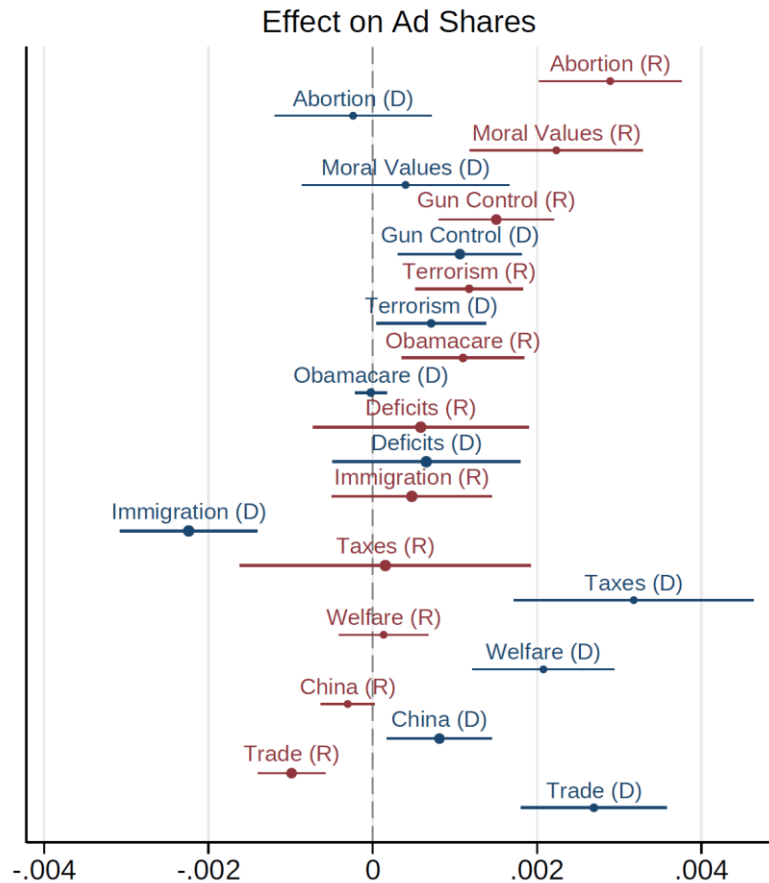
# The West versus the rest

- In the West, liberalism comes before franchise
  - conflation of property rights with minority rights
  - extending the franchise is a compromise for liberals
  - ED arrives when social mobilization is based on class (rather than identity)
- In other nations, even bleaker prospects for LD
  - social mobilization in the context of identity politics (decolonization, wars of secession or national liberation)
  - ethnic/identity cleavages comparatively strong
  - delayed industrialization (and premature de-industrialization), so class-based cleavage comparatively weak

# When might LD emerge? The exceptions that prove the rule

- Weak or non-existent identity cleavages
  - Japan or South Korea (after late 1980s)
- Elite shares identity with minority
  - South Africa (after 1994)
- Multiple identity cleavages
  - Lebanon (until 1975)

- None of these paths is necessarily self-sustaining
- Especially since identity cleavages can be manipulated and rendered more salient by right-wing populists

# How right-wing populists rule: exacerbating identity cleavages



**Effect on Ad Shares**

Notes. This figure shows a coefficient plot from the main reduced-form regression of advertising shares by party on the China shock instrument, for the elections from 2008 to 2018. Red series is for Republicans, while blue is for Democrats. Error spikes give 95% confidence intervals. Coefficients sorted by Republican effect size.

Response of Republican and Democrat ad shares to local import shocks

From: Ash, Mukand, and Rodrik, "Economic Interests, Worldviews, and Identities: Theory and Evidence on Ideational Politics," 2023.