

# 14.773 Political Economy of Institutions and Development.

## Lecture 24. Democratic Consolidation and Origins of Democracy

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# Introduction

- Why do some democracies survive and others go back to nondemocracies?
- Theory of coups
- Why do some societies choose a repressive path rather than democratization?

# Theory of Coups

- Repression: a way of preventing redistributive policies of the democratic system before democracy emerges
- Coups: a way of preventing redistributive policies of the democratic system after democracy emerges

# Model

- Augment the model from the previous lecture with the possibility that the elite can undertake coups against democracy want democracy emerges.
- Symmetric treatment
- After a coup the political situation reverts back to the initial status quo with the elite controlling political power.
- During the coup period, every agent loses a fraction  $\varphi^S$  of their income where the threat state is  $S = H, L$  and  $\varphi^H < \varphi^L$ .
- Assume that in the low threat state, the coup threat is not active, so we set  $\varphi^L = 1$ .
- The relevant cost will therefore be the cost of the elite in the state  $S = H$ ,  $\varphi^H = \varphi$ , and only in this state will the elite want to mount a coup.
- Assume  $\Pr(\varphi_t = \varphi) = s$ .

# Timing of Events

- the state  $\mu_t$  or  $\varphi_t$  is revealed.
- the citizens set the tax rate,  $\tau_t^D$ , if we are in a democracy, and the elite set  $\tau_t^N$ , otherwise.
- in a nondemocratic regime, the elite decide whether or not to repress,  $\omega$ , or democratize,  $\phi$ . In a democracy, they decide whether to mount a coup,  $\zeta$ . If they democratize or undertake a coup, the party that comes to power decides whether to keep the tax  $\tau_t$  set at stage 2 or set a new tax rate.
- if  $P = N$  and  $\omega = 0$  the citizens decide whether or not to initiate a revolution,  $\rho$ . If there is a revolution, they share the remaining income of the economy. If there is no revolution, the tax rate decided at 2 or 3 gets implemented.
- incomes are realized and consumption takes place.

# Markov Perfect Equilibrium

- Similar structure and characterized by two additional thresholds, such that the elite do not wish to undertake coups.
- Define two concepts:
  - ▶ *Fully-consolidated democracy*: no coup even if democracy chooses the bliss point of the median voter (threshold  $\hat{\varphi}$ )
  - ▶ *Semi-consolidated democracy*: no coup if democracy compromises and chooses low taxes (threshold  $\varphi^*$ )

# Markov Perfect Equilibrium (continued)

**Proposition:** There is a unique MPE such that:

- If  $\mu \geq \mu^*$ , the society remains nondemocratic. When  $\mu_t = \mu^L$ ,  $\tau^N = \tau^r$ , and there is no redistribution. If  $\kappa < \kappa^*$ , then when  $\mu_t = \mu^H$ , the rich use repression. If  $\kappa \geq \kappa^*$ , then when  $\mu_t = \mu^H$ ,  $\tau^N = \hat{\tau}$  where  $V^p(N, \mu^H, \tau^N = \hat{\tau}) = V^p(R, \mu^H)$ .
- If  $\mu < \mu^*$ , then we have:
  - - ▶ If  $\varphi \geq \hat{\varphi}$  and  $\kappa \geq \bar{\kappa}$ , we are in a fully consolidated democracy. The society switches to democracy the first time  $\mu_t = \mu^H$ , and remains democratic thereafter, and taxes are always given by  $\tau^D = \tau^p$ .
    - ▶ If  $\varphi^* \leq \varphi < \hat{\varphi}$  and  $\kappa \geq \kappa(\varphi)$ , we are in a semi-consolidated democracy. The society switches to democracy the first time  $\mu_t = \mu^H$ , and remains democratic thereafter. When  $\varphi_t = \varphi^L$ ,  $\tau^D = \tau^p$ . When  $\varphi_t = \varphi^H$ , democracy sets the tax rate  $\tau^D = \tilde{\tau} < \tau^p$  such that  $V^r(N, \mu^L) - \varphi \bar{y} = V^r(\varphi^H, D, \tau^D = \tilde{\tau})$ .
    - ▶ If  $\varphi < \varphi^*$  and  $\kappa \geq \check{\kappa}$ , we are in an unconsolidated democracy. The society continuously switches regimes. In a nondemocratic regime, when  $\mu_t = \mu^L$ , the elite set  $\tau^N = \tau^r$ , and when  $\mu_t = \mu^H$ , they

## Economic Structure and Democracy

- Let us now introduce an explicit economic structure which will enable us to endogenize income distribution and talk about the political implications of different factor endowments.
- Consider a fully competitive economy with unique final consumption good, produced via the aggregate production function

$$Y = F(K, L, N)$$

where  $K$  is the capital stock,  $L$  is total amount of productive land and  $N$  is the labor force.

- For continuity with the model so far, take the special Cobb-Douglas form

$$Y = (K + \sigma L)^\theta N^{1-\theta} \quad (1)$$

where  $0 < \theta < 1$ , and  $\sigma > 0$ .

## Factor Prices

- Suppose only the citizens work, so  $N = 1 - \delta$ .
- This implies

$$w = (1 - \theta) \left( \frac{K + \sigma L}{1 - \delta} \right)^\theta, \quad (2)$$

$$r = \theta \left( \frac{K + \sigma L}{1 - \delta} \right)^{\theta-1},$$

$$v = \sigma \theta \left( \frac{K + \sigma L}{1 - \delta} \right)^{\theta-1}.$$

- Here  $w$  denotes the wage rate,  $r$  the return to capital, and  $v$  is the rental rate of land.

# Factor Shares

- The shares of national income accruing to three factors are given as

$$\begin{aligned} s_N &\equiv \frac{wN}{Y} = 1 - \theta & (3) \\ s_K &\equiv \frac{rK}{Y} = \theta \frac{K}{K + \sigma L} \\ s_L &\equiv \frac{vL}{Y} = \theta \frac{\sigma L}{K + \sigma L} \end{aligned}$$

- The share of national income accruing to labor is a constant equal to  $1 - \theta$ .
- Therefore, analysis so far applies to citizens preferences.

# Economic Structure and the Elite

- What about the elite's attitudes?
- The same as before if a uniform income tax rate.
- But taxes may depend on the source of income (land, physical capital or human capital)
  - ▶ extreme case: land reform
- Also, costs of repression and coups may depend on the structure of the economy
  - ▶ repression may be less costly and agricultural economies
- Finally, if labor-repressive agriculture under nondemocracy, then the elite have more to lose.

# Capital, Land and the Transition to Democracy

- Suppose that if the elite choose to repress in order to avoid a revolution and democratization they will lose a fraction  $\kappa_K$  of the capital stock and a fraction  $\kappa_L$  of land.
- Moreover,

$$\kappa_K = \kappa \geq \kappa_L = \varrho \kappa,$$

where  $\varrho \geq 1$ .

- Then:

**Proposition:** Land-intensive economies more likely to use repression and less likely to democratize because repression is less costly for the elite.

- Intuition.

# Costs of Taxation and Democracy

- Land supplied more inelastically, thus will be taxed more.
- Model this in a reduced-form way by assuming that capital and land taxes are separate, and have costs  $C_K(\tau_K) rK$  and  $C_L(\tau_L) vL$ .
- Suppose

$$C'_L(\tau) < C'_K(\tau) \text{ for all } \tau > 0.$$

- This leads to the same result:

**Proposition:** Land-intensive economies more likely to use repression and less likely to democratize because democracy is more costly for the elite.

# Democratic Consolidation

- Same ideas apply to democratic consolidation

**Proposition:** Land-intensive economies more likely to undergo coups after democratization.

# Economic Structure and Repression

- Same issues arise when we compare to land-intensive societies, but one with more labor-repressive economic institutions than the other.
- The elite will have greater rents under nondemocracy when economic institutions are labor repressive and thus will support political repression to maintain the system.

# Human Capital

- Same ideas can be applied to human capital.
- When human capital is important, taxation more distortionary and less redistribute of taxation.
- Democracy less threatening
- Repression and coups less likely
  - ▶ though the evidence here is not very clear

# Implications

- Societies where labor-repressive agriculture is important (such as Central America), with significant natural resources (South Africa) more likely to resist democratization using repression.
- But so far these ideas captured in the context of unitary elite.
- In practice, within-elite conflict between landowners and capitalists.
- Interesting area: how will coalitions form between different elite groups and citizens?

# The Military

- In all of this discussion, military is absent.
- Repression and coups undertaken by the military.
- Will the military side with the elite?
- Why not use their own power to set up military dictatorships?
- Current and future work...