Does Democracy Need Renewal? Socio-Economic Consequences of Democratic Politics

Author
Masaaki Higashijima

By Masaaki Higashijima

Introduction

Growing mistrust of indirect democracy, the emergence of populism, and widening political polarization – as this "crisis of democracy" occurs, autocracies such as China emphasize that they are superior to democracies in governance. Swift actions against the novel coronavirus and the propagation of fast economic growth are such examples. Indeed, are democracies inferior to autocracies in socio-economic performances?

Modern democracy is a form of political governance which stipulates checks and balances of powers in the constitution, and conducts free and fair elections while guaranteeing citizens' political rights and freedom. This definition of democracy has two dimensions. One is the aspect of "liberalism" where representatives of the people with various ideas and interests compete with one another and restrain the use of excessive power. This dimension includes "horizontal accountability" which denotes the balance of power amongst the executive, legislative, and judicial branches as well as with other monitoring institutions. The other is the aspect of democracy where representatives respond to the will of the citizens (public opinion) through free and fair elections. This is also called "vertical accountability".

In contrast, authoritarian regimes point to a political system where these two types of accountability do not fully function, i.e. one political leader (dictator) monopolizes power and elections are neither free nor fair.

These two factors of liberal democracy have been considered to hold both advantages and disadvantages. The aspect of liberalism constrains the use of arbitrary power, and is expected to prevent the so-called "tyranny of the majority". Yet such political constraints may make it difficult to implement policies in a timely manner and may result in policy stalemate. The other aspect of democracy urges politicians to implement what the general public desires. That being said, the electoral ambition of politicians may also lead to short-sighted policy decisions which provide "bread and circuses" to the general public without viewing issues over the long run. When emphasizing the negative aspects of democratic systems, it leads to the argument of the so-called "developmental dictatorship" where decisions can be made from a long-term policy perspective by a dictator without being exposed to competitive elections.

Based upon these features of democracy and authoritarianism, as well as their advantages and disadvantages in the policy making process, social scientists have accumulated a bulk of research regarding the relationship between political regimes and various socio-economic performances. This article reviews the conditions under which democracy functions well in producing good socio-economic performances. In so doing, I introduce important research that political scientists and economists have published, including my own with my coauthors.

Significance of Horizontal Accountability in Democratic Regimes

Economic policies direct the prospect of a country's economy. Governments formulate fiscal policies; central banks decide on monetary policies. During a recession, they implement expansionary fiscal and monetary policies to improve the circulation of money and stimulate the economy. The monetary policy of Abenomics was a typical example of this. On the other hand, when the economy is booming, these policies are tightened to deter inflation and a bubble economy. Appropriate economic policies reacting to the economic situation lead to deterring inflation, fiscal soundness, economic growth and poverty reduction in the long term.

In contrast to this rationality in policy making, economic policy may be also used as a method for political survival of politicians. Especially under a democratic system where politicians and parties compete, there have been constant concerns that economic policies may be easily used by political leaders to gain popularity from voters. If economic policies are decided with the purpose of staying in power, rather than based on policy rationality, expansionary fiscal and monetary policies may be constantly taken under democracy rather than under authoritarianism. Consequently, those policies may lead to serious fiscal deficits and inflation.

But this perspective on the relationship between democracy and economic policy overly stresses the aspect of vertical accountability in democracy, and underestimates the aspect of horizontal accountability. Professor Cristina Bodea of Michigan State University and I explored the conditions under which *de jure* central bank independence becomes effective in controling government fiscal policies ("Central Bank Independence and Fiscal Policy: Can the Central Bank Restrain Deficit Spending?" by Cristina Bodea and Masaaki Higashijima, *British Journal of Political Science* 47, 2017). Central banks can restrain government fiscal policies by tightening monetary policies by raising interest rates and limiting lending to the government. The central bank's discretion over monetary policy and its policy autonomy are stipulated in the central bank law. The issue is whether governments abide by the agreement over the legal independence of the central bank. In the case of authoritarian regimes, the dictator monopolizes power and thus legal arrangements can be easily reneged on. Therefore, a high level of legal central bank independence may not be regarded as a credible means of preventing any policy intervention by politicians in the eyes of companies, investors, and consumers whose policy expectations significantly influence policy outcomes.

Conversely, in democratic systems, executive leadership is monitored and controlled by the legislative and judicial branches as well as the media, which urges the government to abide by the law stipulating the authority and autonomy of the central bank. Therefore, the high level of legal central bank independence renders high credibility. Consequently, the bank's monetary policy is more likely to impact government fiscal policy, as well as the people's expectations for macroeconomic policy.

We conducted an empirical analysis on the conditions under which the fiscal deficit expands by using data on fiscal balances and central bank independence from 78 countries around the world. Our analysis found that the more democratic a country is (i.e., the higher levels of executive constraints, media transparency, and judicial independence are), the more likely legal central bank independence is to improve fiscal deficits in statistically significant ways. Our results indicate that the very existence of horizontal accountability, which is one of the two elements of modern democracy, allows central banks to act independently and thus could affect government fiscal policy, maintaining policy rationalities.

The power of horizontal accountability is also important when thinking about the manipulation of economic policies for the purpose of elections, or political business cycles. A large amount of research indicates that squandering fiscal policies for election victories is less likely to be observed in advanced democracies, but becomes more salient in new democracies. Using data covering 131 nations of both democratic and authoritarian countries, my statistical analysis investigates under what conditions fiscal deficits worsen during election years. In less advanced democracies and electoral authoritarian regimes where governments hold multi-party elections but those elections suffer from various forms of electoral manipulation, election years tend to experience increases in fiscal deficit ("Political Business Cycles in Dictatorships" by Masaaki Higashijima, *WIAS Discussion Paper Series* No. 2016-002). In emerging democracies, horizontal accountability has not yet been fully institutionalized. In electoral autocracies, governments often exercise large-scale fiscal stimulus around elections to buy off citizens' votes to win elections overwhelmingly, thereby demonstrating regime strength and popularity (*The Dictator's Dilemma at the Ballot Box*, by Masaaki Higashijima, Ann Arbor: University of Michigan Press, 2022). In other words, governments decide economic policies with long-term rationalities when democracy is matured enough to hold robust horizontal accountability.

The Role Expected in Vertical Accountability Under Democracy

Economic policies that a government implements impact a country's economic development and social welfare in the long term. Do democracies outperform autocracies in terms of promoting economic growth and public health? Political scientists and economists have conducted a large amount of research on the impact of democracy on economic growth and public health. In democracy, the rule of law prevails and thus citizens' property rights are secured by effective horizontal accountability. Citizens whose property rights are secured are able to concentrate on investment without the fear of their assets being confiscated by government authorities, leading to economic growth.

On the other hand, democracy also has a path of vertical accountability. To win elections, governments may prioritize political support from the consumption-oriented masses over investment-oriented business elites. If this is the case, the introduction of democracy may discourage investments, which are the driving force of economic growth. From this perspective, authoritarian regimes which prioritize investment-oriented business elites over the general public may be more suitable for economic growth.

Which of these two theoretical expectations does data analysis support? A vast amount of research on political regimes and economic growth has shown varying empirical findings, depending on samples and statistical models. Most recently, however, Professor Domenico Rossignoli of Università Cattolica del Sacro Cuore and his colleagues have conducted the largest ever meta analysis based on 188 research papers which appeared in the past 35 years, including a total of 2,047 statistical models ("Does Democracy Cause Growth? A Meta Analysis of 2000 Regressions," by Marco Colagrossi, Domenico Rossignoli, and Mario A. Maggioni, *European Journal of Political Economy* 61, 2020). Their meta analysis indicates that democracy has a positive direct impact on economic growth, and that this trend is more notable in recent studies which conduct credible statistical analysis through casual inference methods and polished data. Multiple studies have pointed out that economic performance indicators such as economic growth rates tend to be manipulated in favor of governments under authoritarian regimes. Despite likely pro-government data biases in dictatorships, the meta analysis suggests that democracy is more strongly and positively correlated with economic growth compared to its counterpart, firmly supporting the view that democracy does not hinder economic growth, but rather promotes it.

The discussion thus far has indicated the possibility that the vertical accountability in democracies may not help nations score better economic performance than horizontal accountability. In other words, some may wonder if politicians in a democracy could be too preoccupied with the outcome of elections and therefore democracy might not function well to offer anything beneficial to voters.

Protecting public health by social policies is an important role the government plays. While the wealthy are able to enjoy ample medical care and social welfare, the poor cannot receive the necessary social welfare on their own. Introducing fair and free elections may allow politicians aspiring to win elections to listen to the poor majority rather than the wealthy minority. As a result, politicians may promote social policies that improve welfare for the poor. In other words, vertical accountability may be likely to heighten earnest responses from politicians regarding the policy needs of the general public.

To test this empirically, Dr. Susumu Annaka of Waseda University and I analyzed whether and how the introduction of free and fair elections contributes to improving public health by using panel data on infant mortality rates from 172 countries between 1800 and 2015 ("Political Liberalization and Human Development: Dynamic Effects of Political Regime Change on Infant Mortality across Three Centuries (1800-2015)" by Susumu Annaka and Masaaki Higashijima, *World Development* 147, 2021). Our findings indicate that immediately after democratization, governments quickly shift their social and public policies to pro-poor directions, and such policy changes tend to have positive impacts on the long-term improvements in public health. In other words, governments start adopting public policy packages to target a wider array of people immediately after democratization, and such policy changes later contribute to gradual improvement in infant mortality. Conversely, when free and fair elections are undermined, such autocratization leads to negative effects on infant mortality incrementally over time. In line with our finding, Professor John Gerring of the University of Texas at Austin and his colleagues also demonstrate that when countries continue to hold free and fair elections – and therefore the longer democracy lasts – such democratic consolidation is conducive to combatting infant mortality ("Democracy and Human Development: Issues of Conceptualization and Measurement", by John Gerring et al, *Democratization* 28-2, 2021). What these data analyses indicate is that the introduction and consolidation of vertical accountability incentivize politicians to respond to the policy needs of the socially vulnerable, resulting in the significant improvement of public health for citizens.

Is Democratic Governance Almighty?

The data analyses that I have introduced so far have indicated the positive impacts of modern democracy. Can democratic governance, then, claim to be almighty? Unfortunately, this is not necessarily the case. For several socio-economic consequences, research makes it clear that the mechanisms of democracies are not sufficient. The most pertinent issue is wealth inequality. If democratic governments are more likely to adopt policies that deal with poverty, democracy can also be expected to promote wealth equality via taxation of the wealthy and redistribution of wealth to the low-income citizens. However, data analysis on democracy and economic inequality has not found such an empirical pattern to be very strong. Professor David Stasavage of New York University and Professor Kenneth Scheve of Stanford University point to the fact that, although taxing the rich is a reasonable measure to aim for wealth equality, the low-income class have varying opinions on whether such taxation is fair, and thus such a policy might not obtain enough popular support. In addition, in countries like the United States where economic inequality is rising, the wealthy lobby political parties and politicians. As a result, tax systems that benefit the rich are likely to be maintained (*Taxing the Rich: A History of Fiscal Fairness* by Kenneth Scheve and David Stasavage, Princeton: Princeton University Press, 2016). If varying popular opinions on the fairness of taxation and lobbying by the rich are the likely causes of wealth inequality, advancing democratic institutions along the two dimensions of accountability may not be enough to combat growing economic disparity in democracies.

Furthermore, there might be "unintended consequences" that we should beware of as democracy progresses. One such issue is the government response to economic crises. Professor Phillip Lipscy of the University of Toronto studied the impact of political regimes on financial crises by using panel data of 69 countries covering the period 1800 to 2009. His analysis indicates that when democracy in a country is more developed, the more likely it is for severe credit crunches to occur, leading to a financial crisis including closures, mergers, and nationalization of banks. He also claims that strong horizontal accountability may be one of the important mechanisms that create a banking crisis ("Democracy and Financial Crisis", by Phillip Y. Lipscy, *International Organization* 72-4, 2018). Resonating with this, Dr. Daniel Hansen of Carnegie Mellon University argues that when independent central banks have a policy preference for low inflation, economic performances tend to be low after a banking crisis. Unemployment rates tend to remain high; domestic bank credit stays low; stock market valuation experiences drop ("The Economic Consequences of Banking Crises: The Role of Central Banks and Optimal Independence," by Daniel Hansen, *American Political Science Review*, Online First, 2021). These findings indicate that the negative aspects of democrartic checks and balances may appear, especially when swift responses are required to address a crisis.

As confrontation between democracy and autocracy intensifies, authoritarian states may flaunt the superiority of their governance, and people living in democratic states may be faced with the various grave issues that democracy carries. However, much research on political regimes and their socio-economic consequences indicate the fact that democracy has led us to a more desireable society and economy. But this does not mean that we can be content with the current state of democracy. As long as democracy is an "unfinished revolution", properly understanding the issues that democracy cannot solve in its current form, and determining a path for the renewal of democracy, remain an urgent challenge. JS

Masaaki Higashijima is an associate professor of Political Science at Tohoku University. His research interests include comparative political economy, democratization, and autocratic politics. His first book, *The Dictator's Dilemma at the Ballot Box*, is forthcoming from the University of Michigan Press (Weiser Center for Emerging Democracies Series). He holds a Ph.D. in Political Science from Michigan State University.