

## DEMOCRACY AND ECONOMIC WELFARE: AN EMPIRICAL ANALYSIS

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Received: October 17 2018; Revised: March 13 2019; Accepted: March 31 2019

**Abstract:** *This article assesses the relationship between democracy and welfare policy. There are substantial variations in the empirical evidence regarding the relationship between these two variables. While some works showed that there is a systematic relationship between democracy and welfare policy, others failed to show that relationship. We argue that we need to look at the internal political variables within these democracies in order to see what factors within those polities that can lead to a more welfare-oriented policy. We further argue that democracies with parliamentary system and proportional representation are more likely to adopt welfare-oriented policy. Using panel data of 32 democracies from 1961 to 2015, we find some empirical supports for our argument.*

**Keywords:** *Democracy, Welfare, Parliamentarism, Proportional Representation*

### Introduction

Liberalism departs from an understanding that human beings are creatures that are always in progress and struggle towards goodness / perfection. Liberals believe that cooperation will allow humans to achieve better results. A person must be able to look at a problem by considering mutual interests. As explained by Burchill, Liberalism “has championed limited government and scientific rationality, believing individuals should be free from arbitrary state, persecution and superstition. It has advocated political freedom, democracy and constitutionally guaranteed rights and privileged the liberty of individual and equality before the law.” (Scott Burchill, 1992). In this case, liberals consider that in society, government’s role must be minimized and individual freedom,

democracy, and equality before the law must be upheld. Furthermore, in the social realm, the country chooses moral and ethics and cosmopolitan law as the basis for social interaction. Internationally, state chooses international institution as a medium to share goodness.

In the Post World War II, liberalism has been a popular paradigm. This is indicated by the growth of democracies. Democracies are increasingly preferred because they are presumably welfare-oriented. The liberal basic argument regarding democracy and welfare is that democracy will bring prosperity because democracy allows public access toward government policies. In addition, people also have the ability to control the policy makers. This is different from the authoritarian system

which does not open a genuine representative mechanism for its people. The argument on the relationship between democracy and welfare is then articulated in the idea of free markets. As a form of economic democratization, free market gives economic actors the opportunity to produce economic resources that have benefits for all. The free market will bring prosperity just like David Ricardo's and Adam Smith's arguments about invisible hands.

But the fact is that it is not always the case, democracy is not always related to the economic welfare of a country. The fact is that some democracies still have large poverty such as India and parts of Latin America and Africa. On the other hand, absolute Monarchical countries such as Brunei Darussalam in ASEAN, Saudi Arabia in the Middle East and some semi-authoritarian countries such as Singapore and South Korea (until the late 1980s) showed a high level of welfare. We argue that instead of a political regime (democracy vs. non-democracy) that results in welfare, it is the internal mechanism in democracy that might influence a country's preference for welfare orientation.

Before further observing the empirical data to test this conjecture, we will first elaborate literature on the relationship between democracy and welfare to show our intellectual contribution to this issue.

The purpose of democracy is to provide welfare for its citizens. Long debates that occur are still speculative, because they depend on a number of assumptions and statements that must be proven. Not only is the relationship between democracy and well-being non-

linear, it is also very complicated involving many factors, such as history, social structure, education, law enforcement, flexibility and stability of political institutions and so on.

Caoili (2005) argues that most scholars measure democracy using citizen participation, electoral competition and civil liberties. Democracy and development are thought to have a symbiotic relationship where democracy accompanied by market liberalization provides the engine of a country's economic growth. This can occur because the decentralization of political power and market liberalization is considered to contribute to the trust, initiative, investment and growth of producers as market participants. However, domestic stability also plays an important role as a conditioning variable that facilitates the positive influence of capital on economic growth. Political stability enables economic activities to run smoothly which eventually push economy to develop faster. This can apply everywhere regardless of the type of political regime of the country. However, compared to authoritarian system, democracy is considered to be able to resolve social conflicts through non-violent political solutions. This non-violence solution to social conflict tends to result in longer stability. And because social stability is the precondition for economic development, democracy is often seen as the fertile ground for economic prosperity. Thus, democracy indirectly influences economic growth through political stability which attracts investment (Caoili, 2005).

Political stability is an important key in creating economic prosperity in a

country. Political stability is considered to provide a conducive climate for economic growth such as increased investment and other forms of economic activity. In this case the democratic system is considered capable of creating more stable political conditions due to active participation of the community. In addition, with the existence of democracy it is hoped that conflict at the local level can be resolved properly.

Another dimension of democracy that contributes to economic prosperity is economic freedom, especially in the form of free markets. Free market forces economic actors to work efficiently to survive. This efficiency can lead to prosperity because it allows for lower cost of production, hence lower price and higher output. This can subsequently increase income. However, while free market is often said as one source of prosperity—which justifies the relationship between democracy and prosperity, this is not always the case. Just take a look at some prosperous authoritarian countries such as Singapore, Malaysia under Mahathir Muhammad and South Korea under Park Chung Hee and Chun Doo Hwan. Even though they did not embrace democracy and free market, they successfully demonstrate that democracy is not necessarily identical with prosperity. Their success story reveals that rather than the regime type, it is the institutional factors within the regime that might shape the level of prosperity within a country.

While many scholars investigate the effect of regime type on the level of prosperity, some other scholars explore the other way around. One notable

scholar doing this is economist Robert Barro. Barro's analysis shows that increasing living standards - measured by a country's real per capita GDP, infant mortality rates, and the level of participation of primary and male schools - will substantially lead to a more democratic institution (Barro, 1996).

Another scholar such as Joseph Siegle pointed out that countries that have reached the threshold of middle income and are successful in reducing poverty and increasing the living standards of the people will naturally be inclined to be democratic. Openness is a feature of democracy which can help strengthening democracy. transparency provides an opportunity to increase debate and policy analysis that is more informative before government policy is taken. At the very least, such a process is expected to avoid the emergence of policies that can harm society. Thus, it is hoped that the emerging policies will receive support from the public (Siegle,2016:7).

The abovementioned works demonstrate unclear causal connection between democracy and prosperity. The works suggest that the declining trend in infant mortality and the increasing numbers of pupils going to school do not mean that they are caused by democracy per se. Instead, they could emerge because a better development can lead to an improved level of economic prosperity all sectors including education, health and so on.

However, looking at some cases of success story in both democracies and authoritarian countries shows that both regimes can lead to economic growth. Dictatorships are more effective in

encouraging growth and investment by suppressing trade unions, wages, and consumer demand. On the other hand, democracy limits state discretion and is thus more effective at stimulating economic growth because they emphasize credible commitments. In this case the authorities will maintain the trust of their voters to keep the agreed commitments (Durham, 1999).

Thus, economic well-being is also largely determined by the policies of the authorities in both the authoritarian and democratic systems. In this case the authorities in both systems have a commitment to economic welfare. In an authoritarian system, policies taken by the authorities to increase economic growth will sometimes be detrimental to other groups of society such as the workers. As mentioned above, the emphasis on workers is expected to have an effect on increasing investment. This is certainly different from the rulers in the democratic system who seek to make policies that favor their voters. So that it is expected that the voter community can provide input on policies made through existing representative institutions.

From the description above, it can actually be seen that the comparative impact of democracy and authoritarian models cannot be said to have a direct impact on economic development and income redistribution.

However, other scholars also noted that democracy sometimes engenders uncertainty regarding the mode of fiscal and social policy. A change in the governing coalition can change the mode of fiscal and social policy adopted by a democracy. This is clearly shown in Germany at the turn of the 20<sup>th</sup> century

when the progressive movement successfully introduced public participation in the state constitution. Many saw that this effort would have an impact on the institutions that lead to socialism. This can be seen from the experience of Germany which saw the democratic voting model as being considered to create financial policies, such as tax laws, which were driven by populist arguments and endangered the public interest. (P. Feld, A.V. Fischer & Kirchgassner, 2010).

Regarding the impact of democracy on welfare, Siegle saw that the progress of democracy gave rise to hope for prosperity. The adoption of a democratic regime is recognized as having the most dynamic, innovative and productive economic conditions. Economic stability occurs because of the integrity of financial institutions that support it and the protection of property rights that exist in democracy. This condition has enabled countries to implement democracy to improve and maintain the improvement of their people's quality of life for generations. Siegle's study also saw that citizens in developing democracies had a life expectancy of nine years longer, infant mortality rates were 20% lower and secondary school participation rates were 40% higher than those in the countries under the authoritarian regime. In addition, democracies rarely allow their economic conditions to reach the lowest point (Siegle, 2016:1-2).

The explanation above shows that democracy is considered to be creating institutions that have more integrity and transparency. In this case the strengthening of these institutions will

provide more conducive conditions to support economic growth which will ultimately have an impact on people's welfare. Thus, strengthening democracy is considered to provide strong opportunities for the state to improve economic welfare.

The openness of democracy is also considered to have direct benefits for economic efficiency. Greater transparency in the democratic regime is an indispensable factor in controlling corruption which is the biggest obstacle to development. Democracy is considered to be able to create a process of structuring within the country on an ongoing basis. For example, if a leader fails to understand the direction of the policy going forward, then the nature of democracy will correct by encouraging the replacement of leadership through a set of new assumptions and strategies. In this case, democracy is not a guarantee to make improvements in the management of the country. However, they guarantee the right to make changes (Siegle, 2016:7-8).

The connection between democracy and economic prosperity is inseparable from the public attitude towards democracy itself. Public attitude towards democracy is especially important during the period of democratic consolidation. Once the democracy has been consolidated, public attitude toward democracy might not affect significantly the stability of democracy. However, economic condition might determine the fate of democracy. As long as economic prosperity is not under critical situation, democracy can be preserved. This is evidence in South Korea. The successful period of

democratic consolidation, for example, can help maintain the stability of democracy even though the turmoil of the 1997 economic crisis has eroded the level of public trust towards democracy. Though most people consider Korean democracy is not effective enough in facing economic challenge, Korean democracy successfully weather the crisis due to bright history of economic growth (Kang, 2015).

The Korean case above shows that the success of a country in implementing democracy should be balanced by the country's success in increasing economic growth. However, this success still leaves new problems such as economic inequality. This economic imbalance certainly illustrates how a democratically successful country does not necessarily provide a guarantee of the distribution of economic growth in the country. Thus, it can be seen that a country that is successful in implementing democracy will always be tinged with economic challenges related to equitable economic growth.

On the other hand, democracy itself can help push for economic growth. At least in three African countries starting their democratization in the early 1990s—Benin (1990), Mali (1991), and Madagascar (1991), all of them recorded economic growth after embracing democracy. In Benin, for example, the average per capita income grew from 0.28 percent during the 1980s to 1.45 percent after 1991. In Madagascar, despite its meager growth, the average GDP per capita did increase from an average of -1.87 percent before 1991 to -0.75 percent after a decade of waves of democratization. Finally, in Mali, per

capita GDP growth rose from an annual average of -2.24 percent in a decade before 1991 to 2.5 percent in the next ten years (Rodrik & Wacziarg, 2005).

It is seen that democratization will indeed produce benefits. However, a study conducted by Rodrik found that the wave of democratization experienced by some countries could not necessarily have an impact on the impetus for growth and a decrease in economic volatility in the short term. However, the existing empirical argument on the connection between democracy and economic growth cannot be used to argue against political reform in developing countries. On the other hand, the heterogeneity of economic growth in several countries that have followed democratization shows that democratization can create conducive conditions in the political transition which will be expected to increase economic growth.

However, economic growth can also be achieved under authoritarian regime. This can be seen in Africa and East Asia. In Africa, for example, authoritarian regimes maintain economic growth using their neopatrimonial structure with the support of micro-autocratic institutions. Meanwhile in the case of East Asia, political elites use the majoritarian-biased democratic institutions. Empirically this contributes to economic growth (T. Rock, 2013).

Thus, it can be seen that each country will strive to increase economic growth regardless of the system of government they have. Both the authoritarian and democratic systems will create a separate policy model to increase economic growth. Therefore, a number of institutions were formed to

help the government in realizing this. Both democratic institutions and those characterized by autocracy are built to increase economic growth.

Regarding the impact of democracy on policy, Switzerland provides a good example on how the direct democracy impacts on policy. With a clear federal structure, established through direct democracy at all levels (federal, state and local), all forms of public expenditure must be taken into account in terms of the logic of direct democracy. The fiscal referendum is designed to provide space for the public to supervise projects that are considered very slow in their performance and expenditures that exceed the predetermined spending threshold. This, for example, occurs in infrastructure projects or the construction of public facilities (P. Feld, A.V. Fischer & Kirchgassner, 2010).

The role of the community in economic development in a democratic system is needed to supervise policies and the realization of economic development policies that have been made. Through the representation of democratic institutions, it is hoped that policies and their realization can make a positive contribution to the economic development of society.

China provides an interesting lesson how local political institutions could advance economic growth and economic equality. A study conducted by Shen and Yao (2008) using data from 48 villages from eight provinces in China from 1986-2002 shows that democratization at the village level, in the form of local election, does contribute to a more equitable income distribution.

However, China's democratic experiment started in 1987, culminated in *The 1998 Organizational Law of Village Committees* (OLVC), exhibits otherwise. In fact, it is after the implementation of the law that income inequality rose from 0,29 in 1987 to 0,35 in 2000 in China's villages.

This study indicates that the election introduced in China's villages works under what Daron Acemoglu call "a weakly institutionalized governance". This occurs because there is no direct election outside the villages. Democratic process works under the authoritarian mode adopted by Chinese government. Thus, there is support system for the democratization under way. On the other hand, election increases public expenditure, but it does not increase net income transfer within the villages. The positive role of election in reducing income inequality does not come true. Democracy does not help income redistribution in China. Shen and Yao (2008) study contribute to our understanding on decentralization under weakly institutionalized governance.

The case of China above shows that democratization at the local level which is not followed by democratization at the national level will have a sub-optimal effect. In this case, even though democratization at the local level is going well, this policy could clash with the policy model adopted by the central government. Therefore, the formation of democratic institutions is characterized as a weak democratic institution.

Singapore's experience in improving economic prosperity is also interesting to understand. Despite its non-western democratic character, Singapore facilitates popular

representation, political equality and majority rule except in terms of providing adequate political space for opposition parties. Popularly elected governments have controlled freedom in civil society but on the other hand have produced better material life for the population (Caoili, 2005).

The study conducted by T. Meyer (2016) shows that countries with strong welfare are developed under conditions of civil and political liberties. However, this condition cannot be applied in all countries, such as India, Malaysia, Mongolia, Korea and Vietnam. Especially for countries with a legacy of socialism such as Vietnam, Mongolia and China, universalism remains a part of the country's political and bureaucratic culture. In contrast, the political ideologies of the governments of Korea and Malaysia enables them to use a development approach to welfare, as indicated by the government using social policies to industrialize and develop the economy in the 1990s. Authoritarian regimes in China, Vietnam or Bhutan still find it difficult to accept democratic reform for economic benefits. Meanwhile, the development of economic and political liberalization is considered likely to pave the way for equitable welfare creation, although it will not happen quickly. Finally, economic opulence and democratic rights do not necessarily lead to social justice. The case of Europe shows this. Though democracy gives chances to all to participate in the policy process, this still depend on the conditions of who governs, fights and wins the participation.

Variations in empirical evidence regarding the relationship between

democracy and welfare as stated above shows that there are other variables besides democracy that have a major influence on a country's welfare policy. If there is a variation in welfare spending among democracies, it is very likely that it is not only the type of state regime that causes this, but there are other variables that work. Among the institutional variables that we think influence the efforts of democracies to provide welfare for their people are the system of government (presidentialism versus parliamentaryism) and the electoral rule. Because a parliamentary system requires high inter-party trust, especially in forming coalitions between parties (Persson and Tabellini 2003: 24), parties are required to develop policies that are broadly oriented and accommodate constituent interests as widely as possible. We therefore hypothesize that:

*H1: democracies with a parliamentary system will tend to be welfare oriented compared to non-parliamentary democracies*

Electoral rules in democratic countries will also strongly influence the orientation of the state towards the welfare policy. As we know, there are at least two electoral systems known in party systems (the third is a modification of one of these systems), namely majority/plurality and proportional representation. These two electoral systems will influence the policy preferences of parties fighting in a country (Persson and Tabellini 2003). According to Duverger's Law, to define the majoritarian/plurality system will tend to lead to the two-party system

while PR will lead to multi-party (Riker 1994). Because the winner-takes-all rule applies in the plurality system, parties will tend to concentrate on the contested districts—because they have certainly won in their constituencies. In this condition, the policy preferences of the parties will be more oriented to the needs of the contested area. Thus, policy preferences of parties in a plurality/majority system will be geographically-based and limited. Conversely, because the election victory in the PR system is determined by each percentage of votes that can be obtained, then the party policy preferences in the PR system will be broader because the voting concentration is not limited to a particular area. Therefore, party's policy preferences in the PR system will be more oriented towards wider public interests. Therefore:

*H2: Democratic countries with proportional representation electoral systems have a higher welfare orientation than democratic countries with non-PR electoral systems.*

## **Methods**

This study will observe the relationship between welfare spending, as the operationalization of the concept of welfare policy, and a governmental system; and electoral rule in 32 democratic countries from 1961-2015. Due to the missing values in several variables in the countries observed, the total remaining observations were 1,063 country-years. Thus, due to the missing values, the data experienced a shrinkage of almost 40 percent. Most of the data are obtained from comparative political



datasets from 1960-2016 (Armingeon et al., 2018).

In this study, the dependent variable is the proportion of total social security transfers to the GDP. This social security transfer includes social assistance (social assistance grants) and welfare benefits provided by the state to its people. The data come from OECD National Account Statistics compiled in the Database Comparative Political Dataset, 1960-2016 (Armingeon et al., 2018). The electoral system variable is also a dummy where the value of 1 represents the Proportional Representation system and the value of 0 represents non-PR. Data regarding these two systems are available in comparative political datasets.

The control variables used are: (1) GDP per capita of a country. This variable is important as a control because countries with high average income levels tend to allocate large social funds to support the welfare of their society. The source of the data is the World Bank (2018). (2) government budget deficits as a proportion to its GDP. If the government experiences a deficit, it is very likely that the government limits its level of expenditure to social programs. Data source: OECD economic outlook (2018). (3) the level of openness of a country. This variable represents the proportion of a country's total international trade (export + import) to GDP. Data source: Correlates of War Project National Trade data version 4.0 (Barbieri and Keshk 2017). (4) the proportion of state debt to GDP. Countries with large national debt will tend to reduce spending, including spending on social programs. Data source: OECD economic outlook 2018. (5)

index of electoral fractionalization. This index is measured by the formula proposed by Rae (1968):

$$rae\_ele = 1 - \sum_{i=1}^m v_i^2$$

Where  $v_i$  is the proportion of votes for parties  $i$  and  $m$  is number of parties. Countries with a large fractionalization of votes will tend to be public oriented because they must accommodate the interests of a large coalition so that the proportion of welfare spending in these countries will be greater. Data source: 2018 Comparative Political Dataset. (6) proportion of seats for social-democratic and left parties in parliament. Generally, social-democratic and left-leaning parties are welfare oriented. Therefore, the increase in their seats in parliament will also increase welfare spending. Data source: 2018 Comparative Political Dataset. (7) proportion of members of the socialist party and left in the executive cabinet. Just like the argument above, greater number of representatives of socialist/left groups in the government will encourage more welfare spending. Data source: comparative political dataset for 2018. In general, our economic variables are lagged for one year to avoid the possibility of endogeneity in the model.

Because the unit of analysis in this study is country-year, the data will be analyzed using a panel data analysis technique. In this analysis, we use a generalized least square (GLS) model that allows us to correct violations of homoskedasticity assumptions and autocorrelation in panel data. It should be borne in mind that an imbalance in the number of year observations in each country will cause the variance of the

error term of the country to be unequal for all countries. In addition, there is the potential for autocorrelation in the dependent variable because the proportion of current year's welfare spending will be greatly influenced by the proportion of the previous year.

**Results and Discussion**

As seen in table 1, democracies that have a system of parliamentary governance and a proportional representation system have a higher average rate of welfare spending compared with democracies adopt none of the systems. In a democratic country with a parliamentary system, the proportion of welfare spending to GDP is 0.5 percentage points higher compared to a democratic country with a non-parliamentary system. Because the mean of the GDP of the 32 democracies from 1961 to 2015 is around US\$ 300 billion, this means that the parliamentary democracies spend US\$ 1.5 billion higher

than non-parliamentary democracies each year on average.

Likewise, democratic countries with proportional representation systems also have higher welfare spending (2.7 percentage points) compared to countries with other systems (plurality and modified PR). Each year democracies with PR system spend more than US\$ 8 billion higher than non-PR democracies.

Statistically, the results of the estimation indicate a significant relationship between welfare spending and the type of governmental system (parliamentary vs. other) and the electoral system. As predicted, countries with a parliamentary system are more welfare-oriented because the welfare policy is a policy that has a broad impact and can reach the middle class which is the largest pool of votes. Likewise, countries with electoral proportional representation systems also tend to be welfare oriented because parties are forced to follow public will for the sake of voting in elections.

**Table 1: Welfare Spending and Party System**

	DV: Social Security Transfer (% GDP)	
	Coefficient	Standard Errors
<b>Main Predictors:</b>		
Parliamentary	0.459***	(0.171)
PR System	2.761***	(0.189)
<b>Controls:</b>		
GDP per capita [t-1]	0.0000381***	(0.00000399)
Government Deficit [t-1]	-0.183***	(0.0185)
Economic Openness [t-1]	90121.6	(70717.6)
Government Debt [t-1]	0.0225***	(0.00235)
Electoral Fractionalization [t-1]	6.468***	(0.990)
% Cabinet Post Occupied by Soc-Dem/Left Party	0.0230***	(0.00745)
% Seats of Social-Democrat/Left Party	-0.0206	(0.0136)

Constant 2.995\*\*\* (0.739)

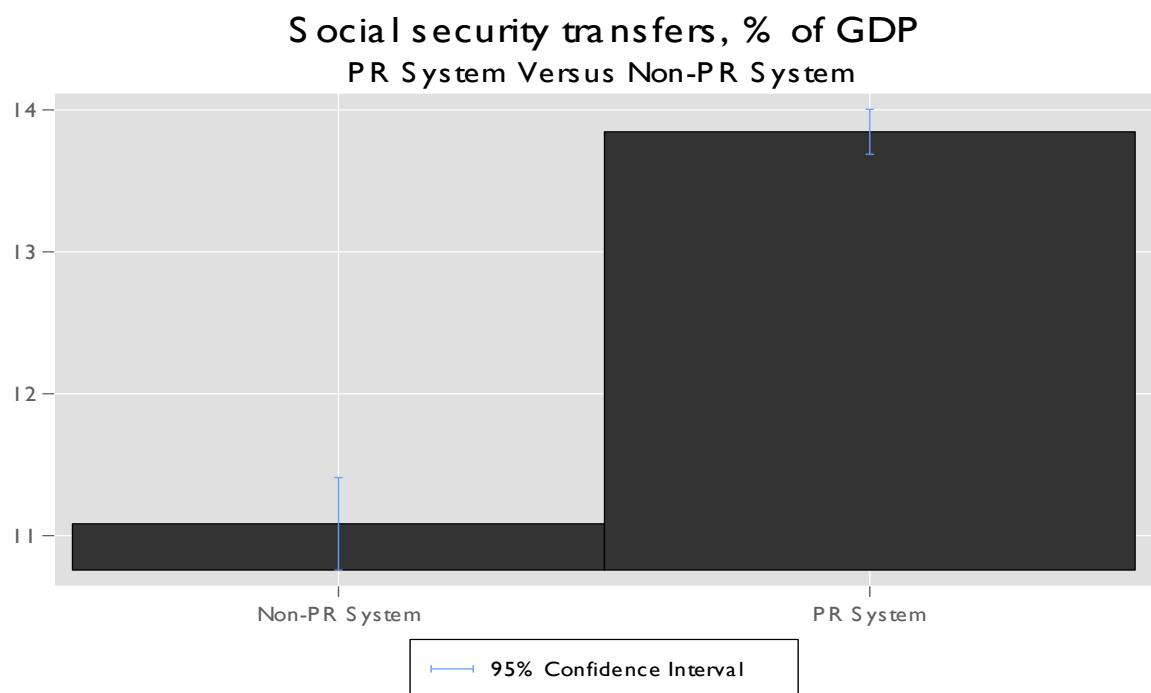
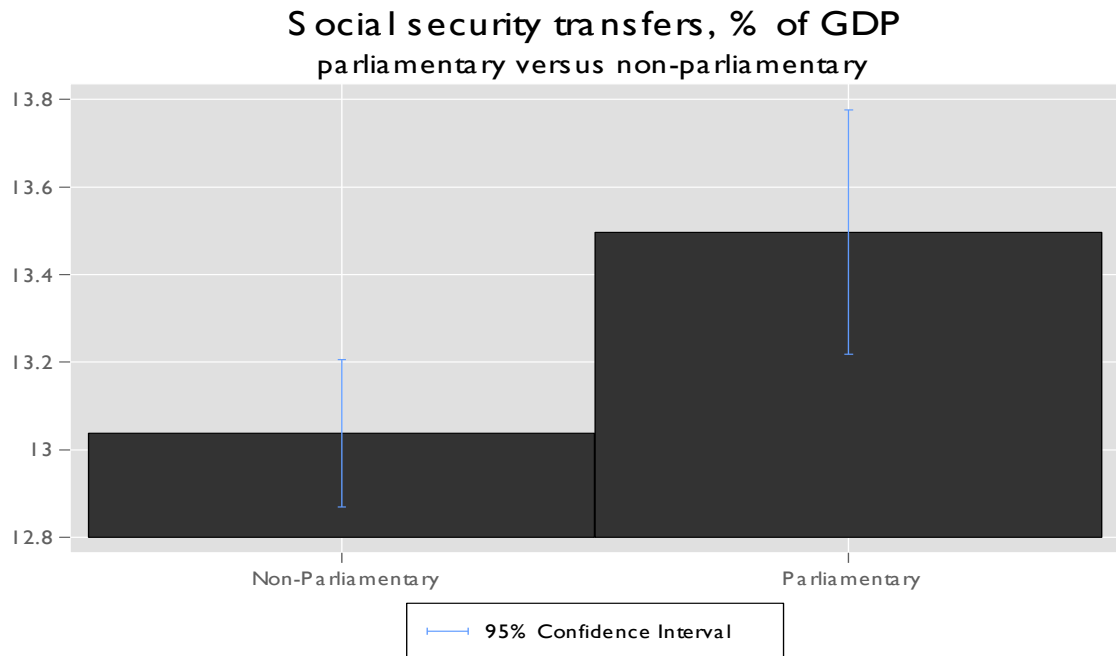
Wald Chi2 822.6

Prob > chi2 0.000

N 1063

Standard errors in parentheses

- $p < .1$ ,  $** p < .05$ ,  $*** p < .01$







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