

The Politics of Global Economic Inequality in the New Millennium

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February 12, 2000

Paper prepared for presentation at the Re-thinking Democracy in the New Millennium Conference, Houston, Texas, February 16-19, 2000, Omni Hotel.

Introduction

This essay explores, in a very preliminary fashion, the political factors that are likely to shape economic success and failure in what we characterize as the period of democratic consolidation that follows the recent wave of new democracies that emerged in the late 1980s and 1990s. More specifically, this is an effort to understand how political factors are likely to either exaggerate or moderate cross-national levels of economic inequality. There is a wide-spread belief by scholars that one of the serious challenges of this consolidation period will be promoting global economic growth while at the same time reducing global inequalities (Lucas, forthcoming).

Our contribution to this debate is relatively straight forward. We argue that widespread adoption of democratic or “seemingly” democratic institutions has had two important implications for national economies. First, the significant reduction in the variation in regime type has undermined the importance of this variable in explaining economic outcomes. Second, the nature of political regimes carries significantly less information for investment capital and hence regime type is much less likely to condition investment decisions. Hence one of the hypotheses proposed here is that over the past four decades, as more countries have adopted democratic institutions the importance of regime differences in explaining economic outcomes has declined.

One possible implication of this diffusion of democratic institutions is that global economic inequalities would decline on the assumption that traditionally levels of democracy has been highly correlated with rates of economic growth. We argue that this is unlikely to continue to be the case because economic progress is shaped by other institutional features. The primary contributing factors include rising levels of international trade and declining trade barriers plus the “privatization” of economic aid to developing countries. Hence we are entering a period in which the state and “para-state” organizations have a declining influence over the allocation of investment capital. With the widespread diffusion of democratic institutions and the privatization of the allocation of investment capital, we hypothesize that regime characteristics as determinants of economic growth are being replaced by more narrowly defined institutional features such as guarantees for property rights. Secondly, investments in human capital, particularly investment in education, has become increasingly important. The widely-accepted reason

for the importance of investment in human capital is that this increases the returns to capital investment. A second, less-widely accepted reason, is that education levels are strongly correlated with support, at the individual level, for property rights. The two human capital hypotheses are as follows:

- 1) returns to investment in human capital have increased significantly over the past four decades;
- 2) we expect to find a strong positive relationship between individuals' education levels and their support for property rights.

Democracy and Economic Growth?

Much of the post-World II period empirical evidence strongly supports the notion that the adoption of democratic institutions promoted economic growth. This seems to be borne out by the bi-variate regression results presented in Table 1. The regression of log real GDP per capita on logged Freedom House (Johnson et al 1999) scores generates coefficients that are close to -1.00 throughout these decades suggesting “constant returns” to rising levels of democratization.

Table 1. Log Real GDP per capita Regressed on Log Political Rights.

Decade	Constant	SE	B	SE	Adjusted R ²	N
1970s	8.98**	.14	-.94**	.10	.42	129
1980s	9.01**	.14	-.92**	.10	.38	145
1990s	9.01**	.12	-1.08**	.10	.48	115

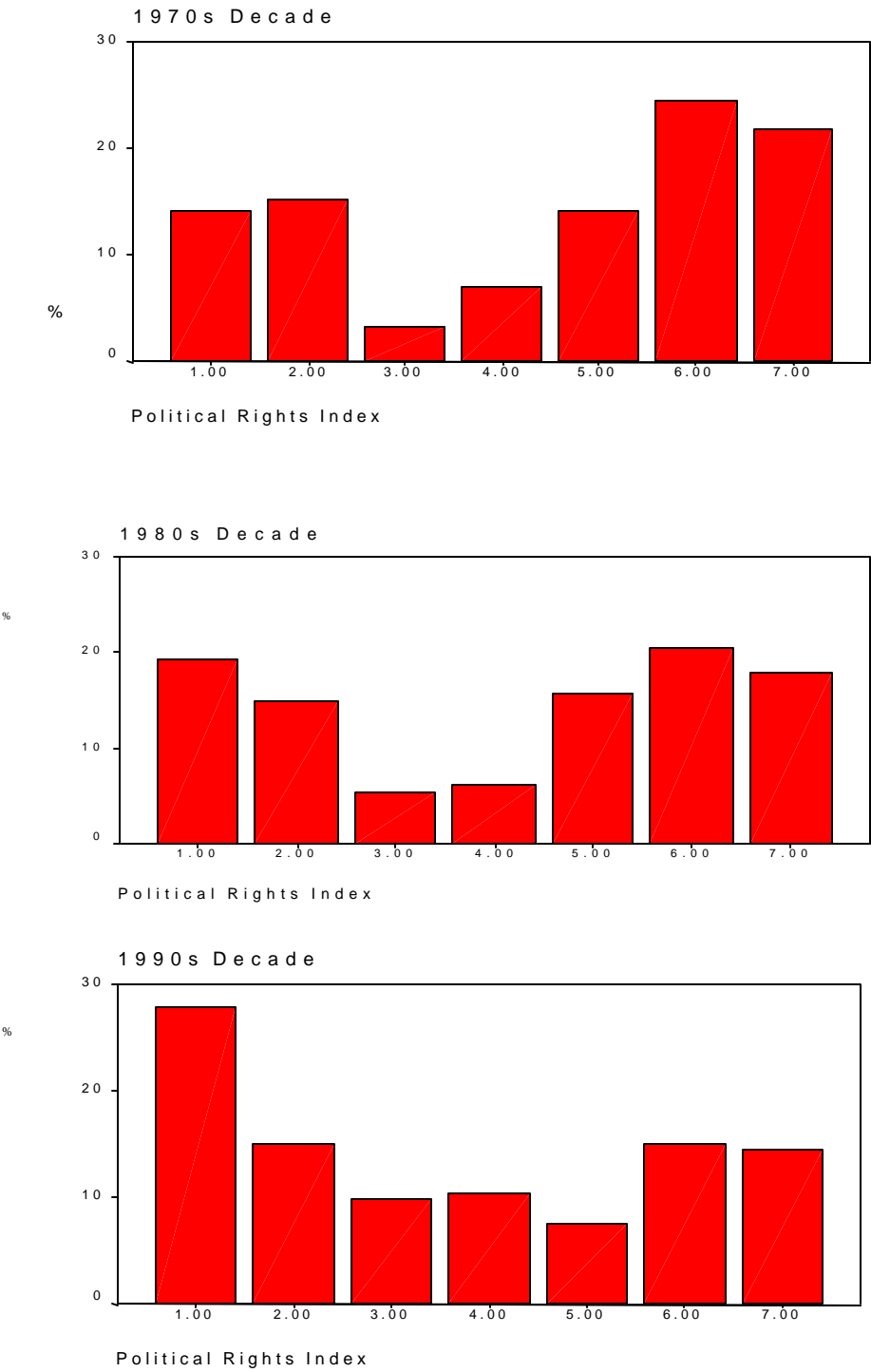
** p<.01

Rising levels of democratization

As Figure 1 illustrates, levels of democratization have clearly risen over the past three decades (note that low scores indicate high levels of democratization). Moreover, many of these new democracies are relatively poor countries. To the extent that there is a strong correlation between democratization and economic performance, this bodes particularly well for the economies of these new democratic regimes.

This recent rise in new democracies poses an interesting puzzle with respect to global economic inequalities. One might expect the less developed new democracies to exploit their “institutional capital” in order to promote accelerated economic development. This would suggest declining cross-national economic inequities in this new decade. We argue in fact that the “institutional capital” that was generated by democratization in past decades has significantly declined. This is not to say that democratic institutions are not conducive to economic development but rather that with the recent widespread adoption of these institutions other institutional features have assumed much greater importance in differentiating the economic potential of different nation states. Two important factors are becoming increasingly important determinants of economic performance and are supplanting political regime as an explanatory variable: rising returns to investment in human capital and property rights guarantees.

Figure 1. Rising Levels of Democratization as Measured by the Freedom House Political Rights Index (Distribution of Countries in Each Decade).

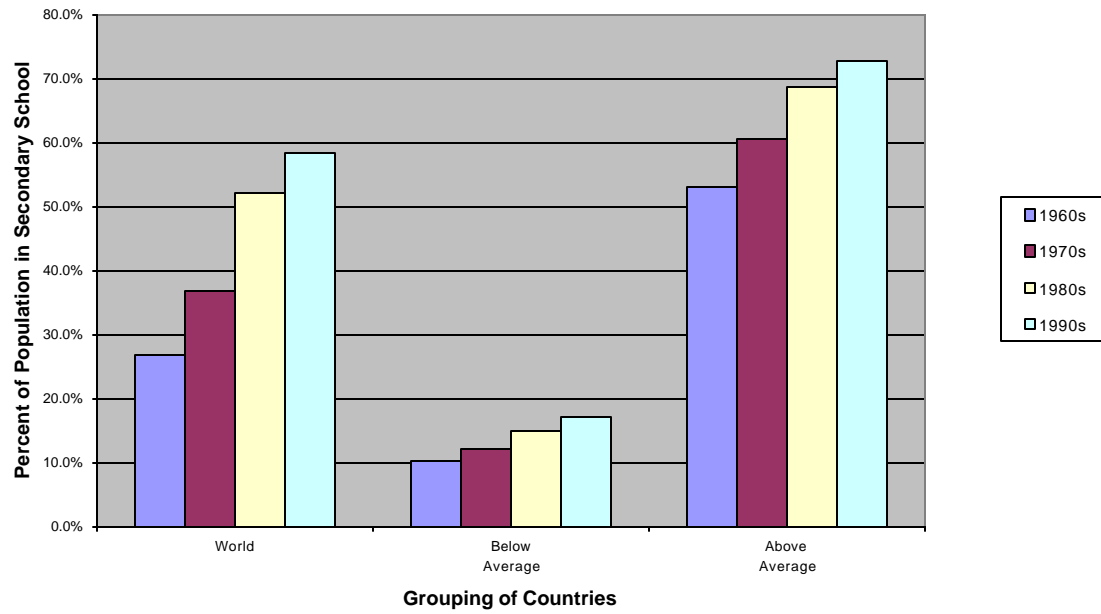


Global Inequalities and Levels of Investment in Human Capital

As Figure 2 illustrates, the world as a whole has made significant advances in education over the past three decades. On average, the percentage of the population enrolled in secondary school according to UNESCO statistics rises from an average of 27% in the 1960s to 58% in the 1990s.¹ Hence the percentage of the world's population in secondary school more than doubles over these four decades. Yet the improvement in education tended to be highly concentrated amongst those countries that were already relatively better educated in the 1960s. The countries that fell below the world average in terms of secondary education in the 1960s, improved their secondary percentage score by about 7%, i.e., rising from 10% in the 1960s to 17% in the 1990s. In contrast, those countries that were already relatively better educated in 1960 witnessed a significant increase in their secondary averages, from 52% in the 1960s to 73% in the 1990s. Our only point here is that these simple comparisons strongly suggest that the trends in investment in human capital over this four-decade period point to rising global inequality in education levels.

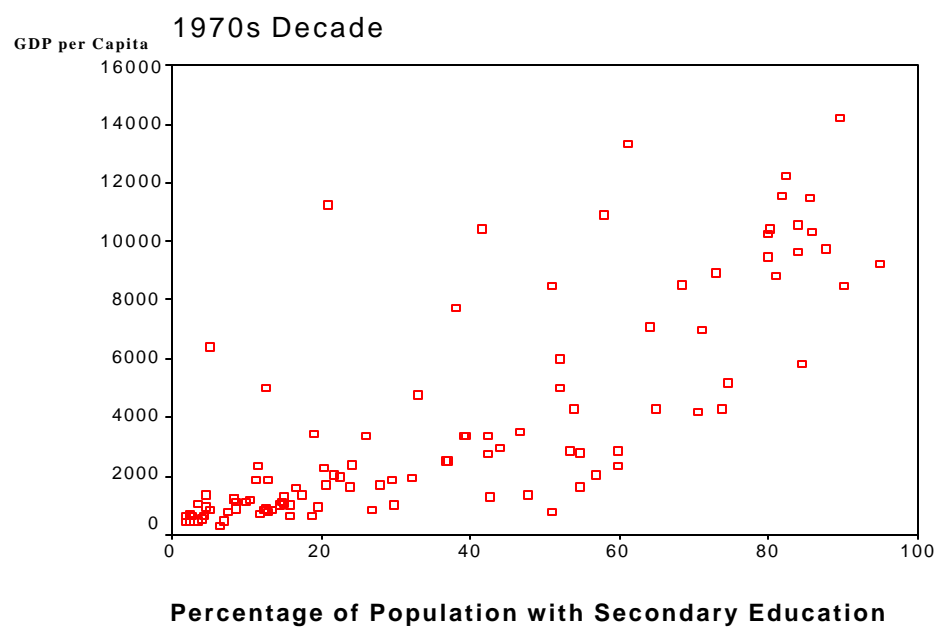
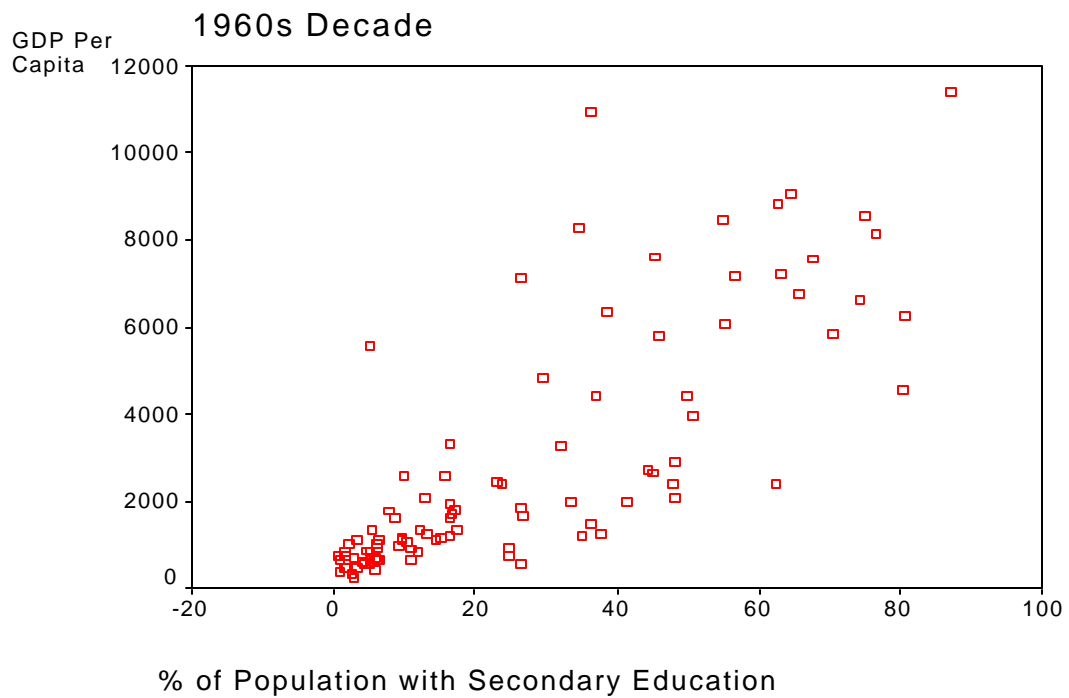
¹ UNESCO, Statistical Yearbook. UNESCO notes that, "Enrollment ratios for the second level are based on the total enrolment including general education, teacher-training and other second level education. It should be emphasized that the gross enrolment ratio at the first and second levels includes pupils of all possible ages, whereas the population is limited to the range of official school ages. Therefore, for countries with almost universal education among the school-age population at the first level, the gross enrolment ration will exceed 100 if the actual age distribution of pupils spreads over outside the official school ages."

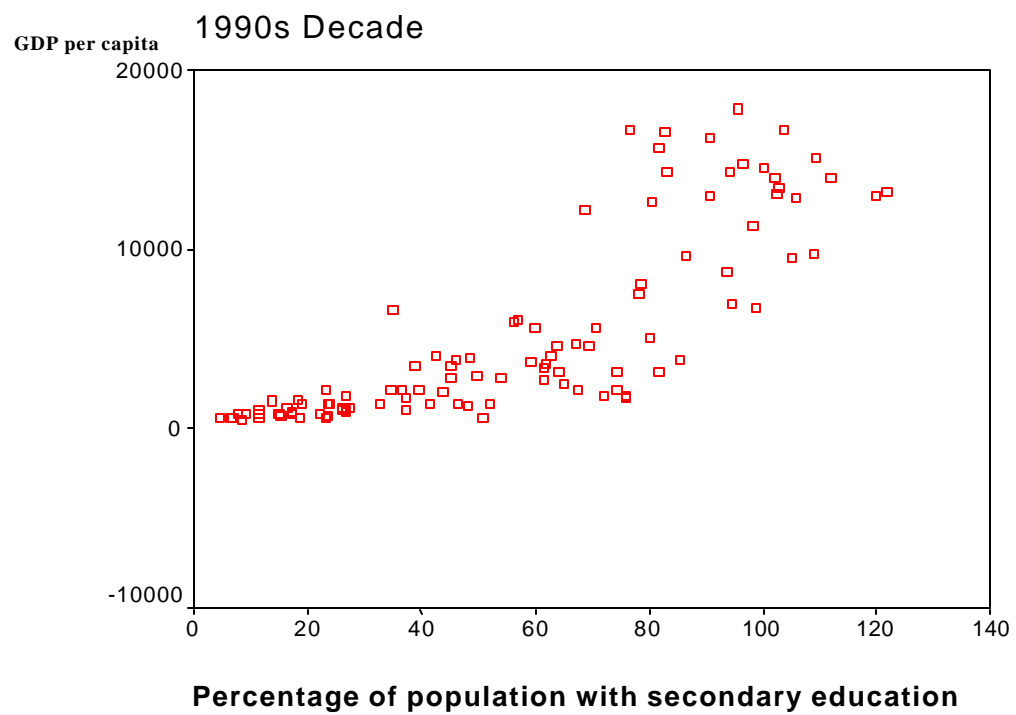
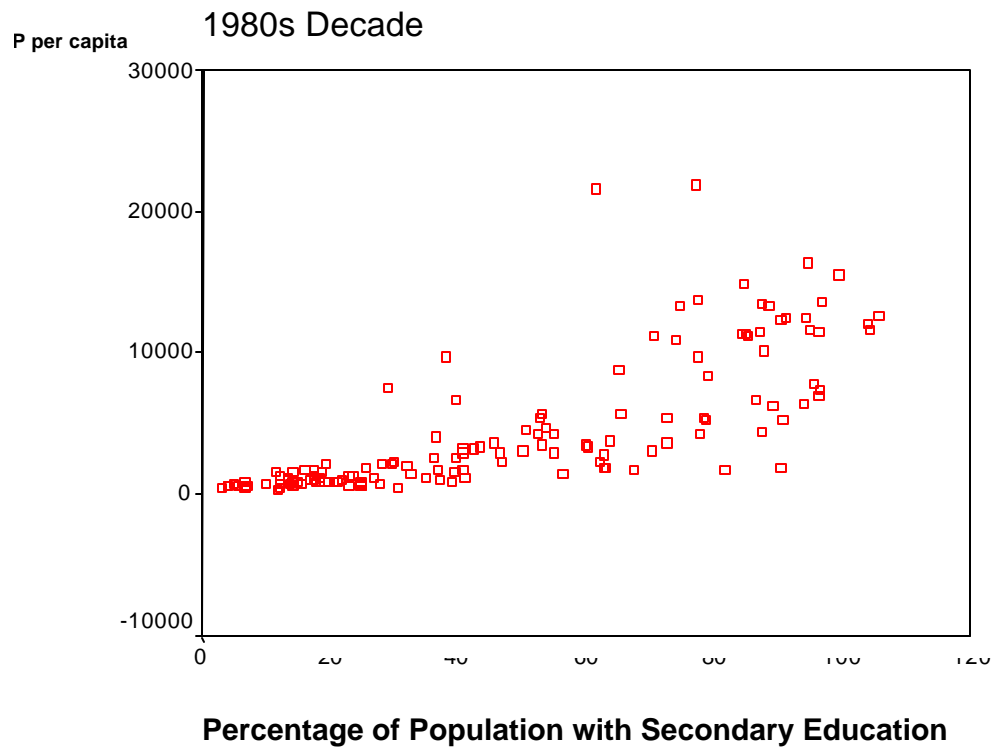
Figure 2. Comparative Education Levels 1960s-1990s. UNESCO



The fact that nations with low levels of investment in human capital have not managed to significantly narrow the gap with the more educated nations of the world contributes to global economic inequities because of the strong relationship between investment in human capital and economic development. The extent to which investment in human capital might exacerbate global inequalities depends on the relationship between the two variables. One possibility is that returns to investment in human capital decline after a country reaches a certain threshold of education and hence as absolute levels of education improve in these laggard countries they will quickly reap the benefits of economic growth. Alternatively, as many argue, the returns to investment in human capital may actually be accelerating which would of course exaggerate cross-national economic inequalities. As an initial exploration of this question we have plotted in Figure 3 the relationship between levels of secondary education and real GDP per capita. Each figure plots the average values for each of four different decades (1960s, 1970s, 1980s and the 1990s).

Figure 3. Plot of GDP per Capita against Education Levels.





The simple plots tell an interesting story about the economic returns to investment in human capital. In the 1960s the returns to investment in human capital appear to be at best constant. By the 1990s, there clearly appears to be exponential returns to investment in human capital. In other words the economic pay-offs are more than compensated by the investment in human capital. We can evaluate this argument by estimating the following equation:

$$\text{Real GDP} = \alpha \exp^{\beta(\text{School})_i} \epsilon_i$$

The estimates for this equation for each of the four decades are presented in Table 2. Note that in fact as we move from the 1960s to the 1990s the returns to investment in human capital clearly increase. In the decade of the 1960s, a percentage change in education results in a .6 percentage change in real GDP per capita. By the 1990s, a percentage change in education levels results in a 1.2 percentage change in real GDP per capita. An important implication of these results is that the education advantage of the developed countries is exaggerating cross-national economic inequalities.

Table 2. Log Real GDP per capita Regressed on Log Education Levels.

Decade	Constant	SE	B	SE	Adjusted R ²	N
1960s	5.83**	.15	.62	.05	.63	
1970s	5.32**	.20	.77	.06	.62	129
1980s	4.03**	.23	1.07	.06	.69	145
1990s	3.47**	.29	1.2	.08	.71	115

** p<.01

Once we take into consideration the fact that investment in human capital, in particular education levels, is increasingly shaping economic performance, we hypothesize that the importance of regime characteristics for explaining economic performance decline. Table 3 reports equations that include both the political rights and human capital variables. There is no evidence here that the impact of the regime variable on the economic performance variable is declining. It remains relatively constant throughout these three decades. On the other hand there is clear evidence that levels of education are gaining in importance relative to the regime variable. Increasingly, educational advantages are much more important determinants of economic success than is the case of the classical regime characteristics.

Table 3. Log Real GDP per capita Regressed on Log Education Levels and Log Political Rights Index.

		1970s	1980s	1990
Constant		-.547**	5.31**	5.03**
		.10	.31	.36
Log Rights		-.55**	-.44**	-.53**
		.10	.08	.09
Log Schooling		.55**	.86**	.91**
		.07	.07	.08
Adjusted R ²		.71	.75	.79
		102	132	102

Notes:

** p<.01

Standard errors inserted below the coefficients.

The unlogged rights index ranges from one for “most free” to seven for “least free”.

Property Right Guarantees

One interpretation of these results suggests a declining relative importance of institutional determinants of economic performance. We do not accept this perspective but rather argue that the institutional factors shaping economic outcomes have evolved with the recent wave of democratizations. Earlier we noted that privatization of the allocation of investment capital puts a premium on more specific institutional features that directly affect inward investment. Hence we argued that the very general regime

characteristic variable is likely to be supplanted in importance by more specific institutional characteristics. In particular, we argued that the extent to which there are institutional guarantees for property rights will have a growing impact on economic growth and hence on the reducing or exaggerating of economic inequities.

The models in Table 4 evaluate the importance for economic growth of the extent to which property rights receive institutional guarantees within each of the countries in the sample. Three variables are included in the models (all are expressed in the natural log): a variable property rights which is based on the Index of Economic Freedom (Johnson et al, 1999); the education variable from UNESCO, and the Freedom House measure of political rights. The results in Table 4 confirm that the extent to which property rights receive institutional guarantees is strongly related to economic growth. Compared to the earlier results, the human capital variable remains highly significant. Note though that compared to earlier results the regime variable declines significantly in importance.

Table 4. Log Real GDP per capita Regressed on Log Education Levels and Log Political Rights Index.

		1990s
Constant		7.67**
		.45
Log Rights		-.18*
		.08
Log Schooling		.77**
		.07
Log Economic Freedom		-1.86**
		.24
Adjusted R ²		.80
N		129

Notes:

** p<.01

* p<.05

Standard errors inserted below the coefficients.

The two unlogged rights indexes range from one for “most free” to seven for “least free”.

The primary message in these aggregate level data is that there are positive, or exponential, returns to investment in human capital and in certain institutional capital,

specifically property rights guarantees. Historical evidence (some of which was presented here) suggests that neither of these two characteristics of nation states are easily changed (note the relatively modest changes in education levels over the past four decades).

Recognizing that many of these relatively underdeveloped countries have recently adopted more democratic institutions, we pose the following question: In the new millennium, can we expect popular attitudes to be a catalyst for promoting investment in human and institutional capital? Or, is the mass public in some sense a barrier to the adoption of these key institutional and policy reforms? To the extent that political elites in these countries are increasingly constrained by popular opinion, will this promote or undermine economic development?

Popular Support for Property Rights

In this section we make a preliminary attempt to evaluate the notion that mass attitudes regarding investments in human and institutional capital represent an important barrier or catalyst to economic development. First, this notion presumes that individuals in these nation states have a set of internally consistent attitudes regarding property rights. A plausible alternative argument is that for the most part the concept of “property rights” has little resonance amongst individuals and that their attitudes regarding property rights are contradictory. We argue otherwise, demonstrating that in fact there is some evidence to suggest that attitudes regarding property rights cluster in a fashion that is consistent with our understanding of the concept. Second, there is considerable variation in our measure of popular support for property rights, both within nations and cross-nationally. This raises the possibility that cross-national variations in support for property rights may become an increasingly important explanation for global economic inequalities.

We see two competing explanations for cross-national variations in popular attitudes toward property rights with very different implications for global economic inequalities. One argument is that these differences represent cultural values and hence are relatively important barriers to economic development. To the extent that attitudes towards property rights are culturally determined, it is unlikely that they would be subject

to short term change and hence could represent a very important barrier to institutional reforms that might establish increased guarantees for property rights. Our alternative explanation is that popular attitudes to property rights are not culturally determined but rather are simply shaped by levels of education. As levels of education rise, individuals develop an appreciation for the importance of property rights and hence are increasingly supportive of this institution. Additionally, we expect that education will have a greater impact on support for property rights in nations where democracy has not yet- or long- been established. In settings where democracy has long been established, norms supporting property rights are more likely to have penetrated all levels of society, regardless of education. We test these three arguments in this section.

In order to test our individual-level hypotheses, we constructed an index of support for property rights from the 1990 World Values Study. Three variables were hypothesized to make up a property rights attitude scale: support for private as opposed to state ownership of business; support for individual initiative as opposed to state responsibility; and support for competition.²

Our primary hypothesis is that individuals' level of education is positively related to their support for property rights. There are, however, a variety of other factors for which we want to control. In addition to education, we expect that wealthier individuals will be more likely to support property rights. Unfortunately, the measure of income in the 1990 World Values Study has a set of fairly complicated problems. For this initial look at the data, we have included the variable *white collar worker* as a proxy for income. We expect, all other factors being equal, such individuals to have greater support for property rights. With respect to gender the conventional expectation is that, particularly in more traditional societies, men have more experience with property and hence are more likely to support property rights. Holding other factors constant, we expect that as

² Of the available variables from the 1990 World Values Study, these had the highest levels of face validity and loaded fairly strongly on a single factor. The dependent variable across the two sets of analyses reported in this section of our paper was calculated on data pooled across 41 separate cross-sections. As a check for the appropriateness of this common index across these widely different national contexts, we conducted separate principal components analyses for each national cross-section. In these analyses, one hundred and sixteen of the one hundred and seventeen factor loadings

individuals age they will generally become more supportive of property rights. We operationalized this variable with a set of dummy variables that identify six different age cohorts.

Table 5: Pooled Models of Individual-Level Support for Property Rights

Variable	Model 1	Model 2	Model 3	Model 4
Level of Education	.047**	.046**	.045**	.048**
Education*Mature Democracy	---	---	---	-.008*
Mature Democracy	---	---	.200**	.253**
White Collar Worker	---	.133**	.118**	.118**
Female	---	-.194**	-.193**	-.193**
18-24 Years Old	---	-.264**	-.228**	-.226**
25-34 Years Old	---	-.211**	-.178**	-.176**
35-44 Years Old	---	-.157**	-.127**	-.125**
45-54 Years Old	---	-.109**	-.082**	-.080**
55-64 Years Old	---	-.047*	-.024	.022
Intercept	-.296	-.101	-.198	.219
R-squared	.01	.03	.03	.03
Number of Observations	47,263			

Notes:

The dependent variable is an index constructed from three questions about property rights. This index ranges from -3.68 to 2.10 to with positive values reflecting higher levels of support for property rights.

** p<.01

* p<.05

Education is measured on a ten point scale reflecting the age at which the respondent finished their formal education.

The omitted age category is people over the age of 64.

The Mature Democracies are Austria, Belgium, Britain, Denmark, Finland, France, Iceland, India, Italy, Ireland, Japan, Netherlands, Norway, Sweden, West Germany, and the United States.

In addition to the individual-level variables, discussed above, we would like to look at the impact of a variety of different institutional arrangements and historical

were in the expected positive direction and were mostly very close to the loadings from pooled scale construction.

experiences on individuals' levels of support for property rights. In the present paper, we have taken a rough first cut at this by identifying which of the different samples were taken in mature democracies. It is our expectation that, all else being equal, individuals in these societies will be more supportive of property rights. The final variable that we constructed was an interaction between our *mature democracy* and *education level* variables. We expect to find evidence that education is a less strong, though still significant, determinant of peoples' support for property rights in mature democracies where a set of shared values favoring property rights have had more time to take root.

Table 5 presents the results from a series of OLS regression models on data from 39 separate samples with our property rights index as the dependent variable. Across these models, the effect of education is highly significant in the expected positive direction. This effect is fairly robust as we move from the underspecified Model 1 to our more complete specification in Model 4. In Model 2, we added our set of individual-level control variables. These variables are all statistically significant in the expected direction. Holding all else constant, white collar workers and older people have higher levels of support for property rights while women are significantly less supportive of property rights. Also as expected, people in mature democracies are much more supportive of property rights. The interaction between *mature democracy* and *level of education* is in the expected direction, indicating that education has a larger impact on individuals' support for property rights in settings where democratic institutions have not long been established.

Table 6: Estimated Effect of Education on Support for Property Rights—Single Sample Models

<u>Mature Democracies</u>		<u>Other Samples</u>	
Austria	.001	Argentina	.047**
Belgium	.060**	Belarus	.042*
Britain	.026	Bulgaria	.092**
Canada	-.019	Brazil ²	.051*
Denmark	.013	Chile	.023
Finland ¹	.085**	China	.042**
France	.052**	Czechoslovakia	.074**
Iceland	-.017	East Germany	-.014
India	.018*	Estonia	.037
Italy	.006	Hungary	.077**
Ireland	.032	Latvia	.053*
Japan	.013	Lithuania	.039
Netherlands	-.010	Mexico	.004
Norway	.030*	Moscow	.095**
Sweden	.040**	Nigeria	.006
West Germany	-.009	Northern Ireland	.104**
United States	.034*	Poland	.059**
		Portugal	-.002
		Romania	.090**
		Russia	.041**
		Slovenia	.066**
		South Africa	.200**
		Spain	.015*
		Turkey	.084**

Notes:

** $p < .01$ (two-tailed)

* $p < .05$ (two-tailed)

The numbers reported above are unstandardized parameter estimates from OLS regression models on the constructed property rights index. Unless noted, all estimates are from a model with specification identical to that of Model 2 in Table 5. There was a fair amount of variation in the estimated effects of age across these individual sample models. Women were consistently significantly less favorable to property rights across all samples while white collar workers were consistently significantly more favorable.

- 1) The Finish model was estimated without the *white collar* variable which was not available.
- 2) For the Brazilian model, there were no valid respondents in the over 64 age category, so the 55-64 age group was the omitted age category.

As a further test of our hypothesis about the effect of education on individuals' support for property rights, we ran separate models for each of our samples. The results for the education variable from each of the 41 resulting separate regression models are

presented in Table 6.³ These results re-enforce the findings presented in Table 5. Overall, education is statistically significant in the expected direction in 24 of our 41 samples (58.5 per cent). The differences in the effect of education on support for property rights between mature democracies and other nations are also apparent in Table 6. Among the mature democracies, education is statistically significant in the expected direction for seven out of seventeen cases (41.1 per cent) while it is statistically significant and in the expected direction for seventeen of the twenty-four other nations (70.8 per cent).

Conclusion

Together the findings from this initial investigation of the politics of global economic inequality in the new millennium provide a mixed picture. Although there remains evidence that the transition to democracy leads to increased economic growth, the marginal returns from such transitions have stayed constant. We have reason to expect that they will eventually decline, especially if the number of non-democratic nation states continues its rate of decline. In a world with only a handful of non-democratic states, other institutional factors will have to play an increased role in determining patterns of international investment and relative economic growth. In this paper we have theorized that investments in human capital and in institutional guarantees of property rights will be major factors. Thus far, we have found support for both of these propositions.

Across the post-World War II period, marginal returns from investment in human capital have increased. This, combined with an increase in the gap between rich and poor nations in their relative investments in human capital, points to a widening wealth gap between rich and poor nations in the new millennium. If the effect of increased democratization on economic growth declines, the picture is quite bleak. An important question in this new global environment is what other factors will take the place of democratization in determining patterns of investment. Our evidence suggests that along

³ Brazil and Finland were not able to be included in the analysis presented in Table 5 due to missing data. They were, however, included in Table 6 with results from appropriately reduced specifications.

with investments in human capital, relative levels of property rights will be a major factor. If property rights are mostly determined by cultural factors short-run change is unlikely. We reject this notion. Instead, we argue that support for property rights is determined by education. Our individual-level analyses found just this. In fact, the marginal returns from education on support for property rights would appear to be strongest among citizens from outside the set of mature democratic nations. Hence, we believe that efforts to educate the populations of developing countries will have two critical payoffs: attract inward investment thereby promoting economic growth in an era of increased privatization of capital investment for developing economies; and secondly raise popular demands for institutional guarantees for property rights which in turn are a catalyst for economic growth.

These results also have important implications for our future research on democratization. In this essay we have examined the importance of democracy as an independent variable in models of global economic inequality. We demonstrate that with the widespread adoption of democratic institutions, measures of democratization are becoming less important predictors of economic performance. Accordingly, there is an increased premium on identifying the particular nuances of democratic institutions that are likely to promote economic development and thereby reduce global economic inequalities. Identifying the nuances of democratic institutions that shape economic and political outcomes clearly is assuming increased attention in the discipline. We consider our findings regarding institutional guarantees for property rights to follow in this tradition. One of the challenges facing students of democratization will be capturing the endogeneity of institutional innovations. What are the political circumstances that are likely to promote the adoption of institutional innovations that will in turn reduce global economic inequities? We make an attempt here to answer this question by modeling, at the individual level, support for property rights.

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