IGC Policy Brief

Title: **Income and Democracy: Lipset's Law Inverted**

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I. *Policy Motivation for Research*

In our paper we revisit Lipset's Law. Writing in 1959, Seymour Martin Lipset reported a strong and positive correlation between income per capita and democracy in a global cross section of nations. He concluded that economic development is a causal mechanism for democratization.
In recent years Lipset's findings have been challenged. While some researchers suggest that the causality runs from democracy to income, others find no significant relationship between democracy and income. In our paper we use recently developed time series panel data techniques to re-examine the relationship between income and democracy. Our findings should inform the policy debate on democratization in developing countries.

II. *Policy Impact*

The contemporary agenda in political economy focuses on the relationship between political institutions and economic development. Our research suggests that countries in Sub-Saharan Africa as well as countries rich in natural resources face particular issues in the democratization process and policy shapers should pay particular attention to these problems.

III. *Summary of Research*

Our estimations suggest three innovative findings. First, in a global sample of countries we cannot decide whether income causes democracy or whether the causality runs the other way round; income and democracy are endogenous. Second, allowing for this endogeneity we find a significant relationship between income and democracy – but one that is negative. This negative relationship is due to the composition of income. When we decompose overall per capita income we find that the source of income matters: the larger the portion originating from natural resource rents, the lower the level of democracy. Thus, countries dependent on natural resources find it more difficult to democratize. Our findings thus present further support for the political economy literature on 'rentier states' and the 'resource curse'.Third, when we concentrate on Sub-Saharan African countries we find evidence that the relationship runs from political institutions – i.e. democracy – to economic performance – i.e. income. Sub-Saharan Africa experienced a wave of democratization since the early 1990s, however, our dynamic analysis suggests that income only slowly adjusts to these new levels of democracy. Sub-Saharan Africa countries may thus be "too democratic" for their current levels of income, with unfortunate

implications for the future course of democracy in the continent and for the ability of democracy to generate future economic growth in this impoverished portion of the global economy. Indeed in line with these econometric results, we suggest that there is evidence of democratic 'back-sliding': several leaders have successfully challenged term limits, there have been a number of recent coups and although all Sub-Saharan countries hold elections many are not free and fair and have been accompanied by large scale violence.

IV. ***Policy Implications***

- There is insufficient evidence to suggest that good political institutions will automatically improve economic performance in all developing countries. Democracy and income are interdependent and policy makers should take this into consideration rather than rely exclusively on 'good institutions and governance' as the key the successful economic development.
- Our research confirms that countries with a high share of natural resource income find it more difficult to democratize. One policy implication based on this result is that recent initiatives to assist countries to use income from natural resource extraction for development should be supported and if possible the agenda should be broadened to include more countries and natural resources. Examples for natural resource initiatives are the International Extractive Industries Transparency Initiative, the Kimberley Process and the Natural Resource Charter.
- Our research focuses on the poorest region in the global economy, Sub-Saharan Africa. Economic development has been patchy with some countries experiencing high growth rates while others are stagnating. For this sample of countries we find that democracy does causally affect economic outcomes. However, incomes are slow to respond to changes in democracy and the region is beginning to experience evidence of democratic 'back-sliding'. For policy shaper this implies that democratic processes should be strengthened, e.g. by assisting the conduct of free and fair elections through election observers and possibly outside military assistance to prevent violence during and after the elections.

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V. ***Audience:***

Academic community, journalists, NGOs influencing public opinion on issues of governance and natural resource management as well as policy advisors (working with and for international development agencies, such as DFID, other national development agencies, the European Commission and the World Bank).

VI. ***Further Readings****:*

Bates, Robert H. 2008. *When Things Fell Apart*. Cambridge University Press: New York.

Collier, Paul. 2007. *The Bottom Billion: Why the poorest countries are failing and what can be done about it*. Oxford University Press.