Synopsis Paper II

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Chapter 1: Introduction

Transformation of European Politics

One of the most important and influential developments in modern history has been the rise and gradual expansion of democratic governments in Western Europe. Over the course of the nineteenth century, many European countries adopted a parliamentary system, the rule of law, and implemented a separation of powers and accountable government. Additionally, arguably the most significant reforms have been the rise of suffrage and eligibility expansions, making the political arena accessible for virtually every citizen, and fiscal reforms encompassing taxation to help secure a small amount of unemployment insurance and pensions. By contrast, in the early 19th century, many (Western) European countries were virtually indistinguishable from autocracies, and were dominated by a small oligarchical elite around the autocrat, usually the king or emperor.

Yet, most of these countries embarked on a series of reforms that started with the establishment of parliamentary sovereignty and increasing its power vis-a-vis the autocrat, and culminated about a century later with universal suffrage. Simultaneously, and in face of changing economic circumstances, these states have also seen a transition from a minimalist government, occupying itself primarily with defense spending, to a government actively intervening in the lives of its citizens, for example, by securing unemployment benefits and pensions, and by actively levying taxation. Strikingly, despite all this, governments and parliaments were dominated by a small political elite for a long time, and remained far from reaching the proportion of present-day (post-WWII) welfare spending. Illustrative examples of this trajectory include Sweden, Germany, the United Kingdom and the Netherlands.

What do we already know?

This transition from autocracy to democracy has been widely studied in various disciplines. In particular, political scientists and economists have offered both theoretical and empirical explanations for why incumbent politicians in an oligarchic political system in which they stood to benefit would agree to potentially far-reaching reforms. Theoretically, various authors have pointed to factors as electoral expediency (Lizzeri and Persico, 2004; Aidt, Franck, and Dutta, 2010), the threat of revolution and mobilization (Acemoglu and Robinson, 2000), or strategic behavior and bargaining between various factors of the elite (Llavadar and Oxoby, 2005). Przeworski (2009), summarizing the literature up until then, largely agrees that suffrage was conquered rather than granted.

The aforementioned largely theoretical work spawned many empirical studies incorporating some micro-level research (Ziblatt, 2008; Aidt and Jensen, 2014; Aidt and Franck, 2015), focusing on specific key episodes of democratization in particular countries and institutional settings (in case: analyzing several reforms in the United Kingdom) as well as macro-level research encompassing multiple countries (Dincecco, Federico and Vindigni, 2011; Aidt and Jensen, 2017), both of which have found evidence that threats of revolution and public activity played a significant role in extending the franchise. Other research has demonstrated that politicians embrace suffrage reform (e.g., Przeworski, 2008; Ziblatt, 2008) or introduce other important changes in the rules governing national elections (Capoccia, 2010b) when it is in their electoral or strategic interest in the short term.

What do we already know?

Secondly, there has been an active literature explaining government size and taxation. Lindert (2003) contains a detailed study about spending patterns and democratization in European and North American states, and shows several findings hinting at a positive correlation between the two. On the macro-level, Dincecco (2011) conducts an empirical study about political transformations and public finances. Similarly, Aidt et al. (2010) and Chapman (2018) find that franchise extension is not associated with increased public spending. Corvalan et al. (2015) find that the extension of suffrage does not increase or decrease government size, when eligibility requirements are in place. They do find that removal of eligibility requirements, leads to the election of less wealthy politicians and the enactment of more redistributive policies in a sample of US states.

Why Does Self-Interest Matter?

The above discussion illustrates that, when looking at the politicians who decided upon the reforms, the theoretical and empirical consensus in economics and political science is that their behavior is characterized by the pursuit of self-interest. Several ways in which the behavior of politicians can be influenced involve *incentivizing* their self-interest towards wanted behavior. The literature has identified various mechanisms such as expedience (public opinion), competition (threat of losing the elections), and many others. Each one of these mechanisms is paired with the assumption that politicians care about something, e.g. electoral mechanisms presuppose that politicians care about being elected. There are also many reasons to suppose that politicians care about their *financial* self-interest, which has been left out of the focus up until now, both theoretically and empirically.

According to Clark (2012), European political elites were dominated by the same groups until several decades after the installment of parliamentary regimes. Other authors (REF, REF and REF) also document the persistence of political elites, which even after parliamentary reforms remained dominated by a small class of individuals. Furthermore, counting from the establishment of parliamentary regimes, it took most countries about a century to arrive at universal suffrage (Przeworski, 2009). Piketty (2014), Machielsen (xxxx) and other anecdotal evidence (Magraw, 1986 for France) also confirms that politicians were often extremely wealthy, belonging to the upper quantiles of the wealth distribution in their countries, and remained so for a significant time. In many countries, the nobility was overrepresented in parliamentary arenas (REF). Hence, the literature contains a paradox that has not been resolved so far: given that politicians approved these far-reaching reforms, to what extent were politicians' financial self-interests at play, and if they were, what constrained the self-interest of the political elite?

Approach

To answer these question, I turn to the case of the Netherlands. [Explain why it is a good case among all European countries.]

As mentioned, the theoretical consensus in economics and political science is that politicians' behavior is characterized by the pursuit of self-interest, and that they need to be disciplined one way or another to refrain from pursuing their self-interests and to be responsive to their electorate. When investigating these reforms from the viewpoint of individual politicians. But what is exactly the self-interest of politicians? In this paper, I employ arguably the most obvious proxy for a politician's self-interest: their personal wealth, and I analyze the influence of politicians' personal wealth, amidst many other factors suggested by competing theories, on the probability of acceptance in a host of fiscal reforms, suffrage extensions and government interventions. [Explain there is good data]

Personal wealth might causally influence voting behavior because acceptance or rejection of reforms might influence politicians' future cash flows in various ways. To ensure a causal interpretation of the estimates, we employ several estimation procedures. In particular, we provide several instrumental variable (IV) estimates of personal wealth on the propensity to vote for reforms, instrumenting parental wealth by an indicator whether the politician's father was also politically active. I also rely on various other alternatives to limit the bias caused by endogeneity by relying on (plausibly exogenous) timing of death among politicians.

Chapter 2: Key Laws in the Transition

Political Transition and Oligarchical System

To a large extent, the far-reaching changes across Europe in the nineteenth century can be characterized by three major trends: first, an increase in active suffrage, usually focusing on relaxing the requirements that granted individuals the right to vote. The diversification and broadening of the electorate also caused a shift in parliamentary composition: whereas parliaments were historically dominated by the nobility and circles close the autocrat, over time, parliaments become more diverse, but still dominated by a layer of legal specialists, theologians and other trained men. The key laws underlying these changes were implemented in a series of constitutional changes, which legitimized and implemented these expansions, and happened in the Netherlands in 1887, 1896, 1917 and 1918. It is also noteworthy that the trajectory did not happen without recoil: several law projects attempting to extend the franchise (in 1872 and 1896) were also rejected on various grounds. The consensus underlying these franchise extensions also varied from project to project, allowing for sufficient variation in voting behavior to be studied.

Secondly, as documented by Lindert (1994), the general view of the state as a passive actor guaranteeing only the security of its citizens evolved into views that accorded the state a more interventionist role, although opinions about exactly how far that should go differed sharply. The responsibility for such a shift in attitudes across the continent lies with increasing social tension and poverty that came with industrialization. This initially prompted many parliaments to approve and oversee legislation prohibited child labor and establishing legal working hours. This served as a precedent for a more interventionist role of the state in markets and economic life of its citizens more generally: in the case of the Netherlands, the era of 1870 to 1920 is marked by several laws regulating education (1900), housing (1901), higher education (1904), labor contracts (1907), among others. Significantly, and in contrast to several other countries, the majority of these laws burdened not the state, but private actors such as employers with the execution (and financing) of these provisions, rather than the state. In the decade starting from 1910, some exceptions to the rule are laws attempting to instigate a state pension (1913, 1916), which were only executed later.

Thirdly, despite that most government intervention targeted to limit governmental transfers, government size steadily increased, reaching levels significantly higher than ever before in history, although not nearing the standards of present-day. Increased government spending was necessitated by several exogenous trends: the stalling of revenue from colonies necessitated higher domestic taxation to balance the budget, but the aforementioned expansion of the government into many areas of life also required funds. The tax system, based predominantly on excise duties and tariffs was also widely considered to be outdated. Finally, and most significantly, social tensions and perceived inequity were widespread, and arguably shifted the consensus towards acceptability of increasing taxation, sometimes even rendering taxation progressive.

The most important developments in fiscal legislation include the creating and development of an income tax (1893 and 1914), which included a progressive tax rates. The 1914 hike in turn increased basic tariffs and progressivity. The other major source of tax revenue was inheritance taxation, which established a basic tax rate on inheritance to lineal descendants in 1878. The rates were increased in 1911, 1916, and 1921, but unlike the income tax, there was no progressivity.

Impact on Ideology

In the political economy literature (as in Trebbi, Sufi, Mian, 2010), politicians' preferences are usually modeled as a function of their ideal policy and some component that reflects self-interest. In this context, the acceptance of each of these laws can influence politicians' utility in two ways: it can influence the state of the world in such a way as to come either closer to their ideal state, $p_i^* \in [0, 1]$, or farther. Secondly, political are supposed to care about their financial interests. Both considerations might lead them to decide upon accepting the laws according to:

$$U(p, W) = -(p - p_i^*)^2 + \beta \cdot f(p, W_i)$$

where $p \in \{0, 1\}$ is the acceptance of the law, and $f(p, W_i)$ is a function representing the impact of the acceptance of the law on their own wealth W_i. A politician's p_i^* may also be thought of as *ideology*, the way in which politicians value the state of affairs in the world.

Impact of Law on Ideology

Laws can impact the state of affairs in the world in various ways. First, politicians might have preferences over social and societal outcomes that might be affected by the law. For example, politicians might be convinced that the particular government intervention increases equality and equity, helps poorer individuals in general, or helps a particular ethnic, religious or economic group (all of which they may or may not value). They might also think the opposite, meaning the law can potentially disadvantage certain groups, such as employers, employees, a certain demographic, etc., all of which they might again value or disvalue according to their worldview.

Keeping their moral values and preferences over social outcomes fixed, politicians might also not be convinced that the law in question solves the problem it attempts to solve, or indeed creates additional problems outweighing the initial problem. For this reason, their preferred outcome for such a law would be $p_i^* = 0$. Furthermore, some politicians might be ideologically in favor of free markets, and any government intervention can be thought of as bringing disutility to this group of politicians, which would be reflected in $p_i^* = 1$.

It is also known that some socialists thought that government intervention did not go far enough, or that some conservatives thought that it went too far. This can be reflected in a $p_i^* \in (0, 1)$, meaning that they suffer utility loss from a law that is less than somebody who is absolutely against it if accepted or absolutely in favor of it when rejected. Finally, politicians' might also feel animosity or hostility towards a particular colleague, leading them to prefer the law to be rejected, despite any eventual merits the law might have.

Impact of Law on Ideology: Gov't Intervention, Fiscal Legislation, Suffrage Extension

In this subsection, I explain the possible channels through which the three categories of laws, government intervention, suffrage expansion and fiscal legislation, can influence a particular politician's p_i^*,

- Government intervention: Government intervention encompasses intervening in markets that were otherwise untouched. They represent many of the special cases touches upon above. For example, the compulsory education laws in 1901 likely increased equality and equity, the 1874 law regulating child labor helped children and the poor more generally, and the law regulating strikes (1903) might have solved one problem (strikes) but caused another (more revolutionary potential) according to at least some politicians. Similarly, the 1901 housing law might have disproportionately concerned particular groups (workers), and laws regulating labor contracts (1907) and offering protection to workers might or might not have had the intended effects (securing the position of workers vs. creating unemployment), depending on the politician's ideology.
- Fiscal legislation: apart from personal financial gain, which the next session will address, fiscal laws might bring more equity and equality into the world, which politicians might value or disvalue. Fiscal legislation also increases government size. Furthermore, taxation can involve a societal dead-weight loss, which might lead some politicians to weigh this against the potential societal benefits.
- Suffrage extensions: suffrage extensions might again increase equality and equity, or the opposite, depending on the ideological viewpoint. Suffrage extensions might also represent a shock to expectations about future governments, parliaments and corresponding future laws and future states of the world, which politicians might anticipate and factor in their decisions.

Impact on Personal Wealth: Gov't Intervention, Suffrage Extension

There are also direct and indirect ways in which accepted legislation can directly influence a politician's wealth.

- Government intervention: government intervention not concerning the government budget may influence politicians' wealth indirectly in ways dependent on the specific law: laws regulating labor (e.g. labor accident law 1901; labor contract law, 1907; sick leave law, 1913) might influence the wealth of politicians who own firms or shares, who might have a lower profit rate. Similarly, the 1901 housing law might have lead to increased municipality-level taxes, and might have lead to decreased equilibrium rent payments (the effect of which is positive/negative depending on the real estate holdings of the politician) because of increased housing supply. More indirectly, The anti-striking laws of 1904 might have reduced the amount of strikes, decrease the loss of firms, and increase the wealth of shareholders. The compulsory education law (1900) might have increased wages and decreased profits due to increased scarcity of labor.
- Suffrage extensions: directly, franchise extensions might increase competition, and hence decrease the likelihood of them being able to stay in politics, which might reduce their rents and employment prospects. Indirectly, it might represent a shock to expectations about future governments and parliaments, which might influence future fiscal policy. Politicians might anticipate this when deciding whether to vote in favor of a suffrage extension.

Impact on Personal Wealth: Fiscal Legislation

- The impact of fiscal legislation on politician's wealth is most obvious: in case of an increase in taxation, the expected costs C_i for a politician as a function of their income (income tax Inc) or wealth (inheritance tax Inh) can be approximated:

$$C_i^{\text{Inc}} = \sum_{t=0}^{T} \frac{\tau_i \cdot Y_{it}}{(1+r)^t} \text{ and } C_i^{\text{Inh}} = \frac{\gamma \cdot W_i}{(1+r)^T}$$

where τ_i and γ are the income-dependent (progressive) tariff and inheritance tariff for politician i, Y_{it} is their income and wealth respectively, T is the expected lifespan from the time of acceptance of the law, and r is an exogenous interest rate.

- [Do this calculation with a few numbers and stress that wealthier politicians pay more]
- [Stress that wealthier politicians are less inclined to vote "no" when maximizing their utility]
- [Stress that acceptance of taxation also creates public goods, which benefits politicians, but unlikely the wealthy politicians]

Chapter 3: Measuring Wealth and Voting Behavior

Methodology: Controlling for Wealth Composition

Methodology: Estimating the Effect of Wealth on Voting Behavior

Sources

Chapter 4: Analysis

OLS Analysis

IV Analysis

Harnas Analysis

Chapter 5: Robustness Checks

Alternative Estimates OLS

Alternative Estimates IV

Chapter 6: Interpretation and Conclusion

Interpretation

Conclusion