

# THE PRODUCTIVITY TRAP: DISGRUNTLED ELITES, RENT-SEEKING AND THE DEMISE OF DEMOCRACY

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## INTRODUCTION

Democracy's expansion is over. No new democracies have emerged since 2008.<sup>1</sup> Recent autocratic reversals in Venezuela and Turkey, coupled with the election of leaders like Donald Trump in the US and Andrzej Duda in Poland, have sent political scientists and the public in general into a frenzy. Why are developed democracies, which appeared impregnable just a few years ago, backsliding?

This article provides a theory of democratic erosion from a political economy perspective that explains this puzzle. The central argument is that a large productivity gap between economic groups motivates those with low productivity to use the state for rent-seeking. Expectations of lower wealth in the future force these groups to seek control of the state, in an attempt to compensate for their losses and prevent high productivity groups from continuing to increase the wealth gap. A Caesarian leader emerges from within the party system or as a political outsider and provides a political base and promises of rents to these elites in exchange for political power.

Consider the cases of the Spain and the United States, two countries that have experienced some level of democratic erosion in the past few years. In Spain, leftist political party *Podemos* emerged in 2014 to channel the political discontent caused by the domestic housing crisis of 2007 and the global financial crash of 2008. Government spending cuts and labor market reform in the private sector targeted low productivity sectors and workers, who bore the brunt of the adjustment.

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<sup>1</sup>See Boix, Miller and Rosato, 2012. Expanded to 2015 by the authors of the original dataset. Expanded to 2018 by the author of this manuscript.

Pablo Iglesias, Podemos' charismatic leader, shot up in the polls with promises of a large increase in minimum salaries, the nationalization of utility companies, and guaranteed monthly income for all citizens. His anti-elite discourse crystallized in popular catchphrases such as *la casta*, a slight against individuals with 'pedigree' and influential family lineage. Given the historical roots of the conservative Popular Party (PP) party in Franco's Spain, most of the *casta* has direct or indirect ties to the PP. In Spain's case, the struggle for state control was between low productivity workers and a set of elites that remained fairly united –no sectors were particularly productive in comparison to others. These united elites gave the conservative Popular Party greater leeway to crack down on opposition, increasingly restricting the right to protest through the *ley mordaza* and free speech.

In the United States, on the other hand, the productivity gap took the form of a pronounced elite cleavage, brought on by globalization and technological progress: high productivity sectors in technology and finance versus low productivity sectors in natural resource extraction, industry and, more specifically, manufacturing. The latter sectors were against the reelection of the Obama-Clinton coalition, and eventually threw their support behind Donald Trump rather than form a protective wall against a candidate with non-democratic traits. Thus, in the US, polarization was most pronounced in the *economic* elite, as opposed to among voters (Svolik 2018) or the political elite (Bermeo 2003, Linz and Stepan 1972). A high productivity gap between economic sectors facilitated the rise of Trump in the US, while in Spain, the productivity gap was between .

I use the term 'democratic erosion' to reflect the gradual process whereby democracy drifts toward autocracy (Bermeo, 2016; Lust and Weldner, 2015). It must be distinguished from democratic breakdown, which reflects the return of an authoritarian regime where a country had been fully democratic. For instance, Venezuela suffered a breakdown in 2006 and Turkey in 2016. Certain democratic practices still exist in these countries, such as multi-party elections, but freedoms have been curtailed to such an extent that competition is patently unfair and all parties know ex-ante the result of the election. Conversely, while democratic quality is decreasing in advanced democracies

such as the US, Poland, France or Spain, these countries remain democratic. In these countries, we are not discussing democratic breakdown, but the potential breakdown of the democratic equilibrium. Nor are we observing the full dismantling of democratic procedures, but the reshaping of institutions and systematic attacks on democratic norms. Thus, to study democratic erosion or ‘backsliding’,<sup>2</sup> a more expansive vision of democracy is required (Lust and Weldner, 2015; Svolik, 2018).

This article makes a few important contributions to the emerging debate on democratic erosion and informs the debate on democratic breakdown (Bermeo, 2016; Diamond, 2015; Lust and Weldner, 2015; Miller, 2018; Svolik, 2015, 2018). It is the first one, to the author’s knowledge, to address the political economy angle of the recent trend toward democratic erosion. It ties many important processes that have developed since the end of the Cold War, such as greater globalization, factor mobility and technological innovation, into the simple concept of the productivity gap. Indeed, one can think of the productivity gap as the result of a global economic shift brought on by globalization, in which old industrial sectors in developed economies are losing out to new and innovative sectors that yield high profits in the global market. It also provides an explanation that links wealth inequality to both voter mobilization by political entrepreneurs and the role of the elites as democratic gatekeepers. In doing so, it places special emphasis on the ‘choices and choosers’ involved in backsliding while accounting for important economic factors that influence institutional change (Bermeo, 2016). I proceed as follows. After describing and defining the recent process of democratic erosion, I develop my wealth inequality argument and support it using both quantitative and case study evidence from the US and Continental Europe.

## DEMOCRATIC EROSION IN DEVELOPED ECONOMIES

Widespread democratic erosion in advanced economies is a recent phenomenon (Bermeo 2016, Lust and Waldner 2015). Various measures show that democracy expanded in the developed world until around 2012, when a process of deterioration began.<sup>3</sup> Democracies such as Poland or Hungary marched decisively toward autocracy, while liberties were curtailed in other established democratic polities. In France, the fight against terrorism by French nationals who joined ISIS prompted the state to surveil its own citizens, often with weak evidence of wrongdoing. EU states have responded to the new influx of immigrants fleeing conflict in Africa, the Middle East and Central America with solutions of questionable democratic quality that contravene various international treaties. Free speech is becoming less free. In Spain, in a rather comical twist, two puppeteers were jailed for invoking the name of defunct Basque terrorist group ETA in a 2015 show. A rapper was recently given a 3 year prison term for inflammatory lyrics against the Crown. Poland's Duda has been systematically attacking the judiciary in an effort to wean its powers and act with greater impunity,

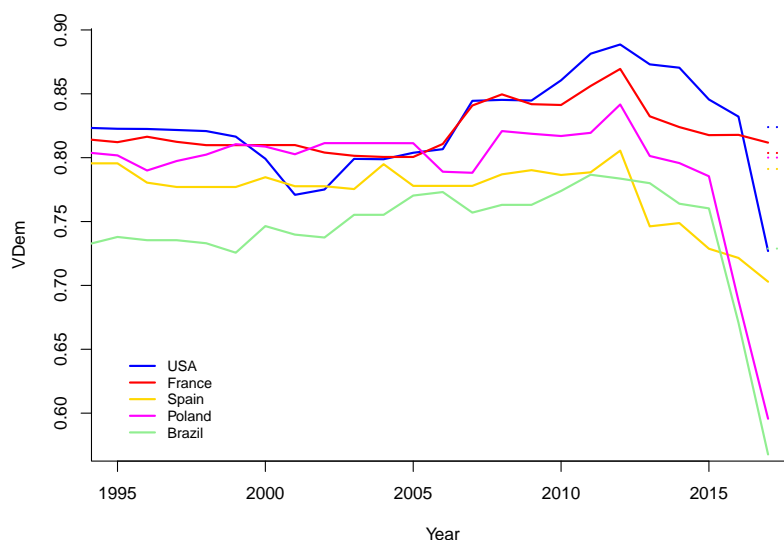


FIGURE 1. Evolution of V-Dem scores by country since 1995.

<sup>2</sup>I use these two concepts synonymously.

<sup>3</sup>See the Varieties of Democracy (V-Dem) and Polity datasets.

a similar strategy to Orban’s in Hungary. Figures 1 and 2 confirm this pattern. Figure 1 shows the evolution of V-Dem’s continuous measure of liberal democracy for five developed countries. Democracy kept on its slow but steady progress until around 2012, when a decline begins.<sup>4</sup> Most countries’ scores have since decreased to unprecedented levels, and some to historical lows, as in Spain and Poland. The US score is the lowest since Nixon’s presidency.

However, while democracies are losing their luster, the number of democracies and autocracies in the world has remained stable in the last decade, as Figure 2 illustrates. Plot (a) shows the evolution of democracy since 1950 and the sharp uptick in the number of democratic states during the third wave from the 1970s until the 1990s. Plot (b) then displays two flat lines that depict the worldwide democratic halt of the past decade. No democracies are coming into existence, and no autocratic regimes are failing. Part of the explanation for this puzzle is that declines in democratic quality are not sufficient for countries to lose their democratic status. Democracies are becoming more like autocracies in weakening the judiciary and curtailing civil and political rights, but they remain democracies. Thus, the evidence shows that this is a problem of democratic *erosion*, not *breakdown* –at least not for time being. While we may be on the way to notorious breakdowns, we are not observing them yet.

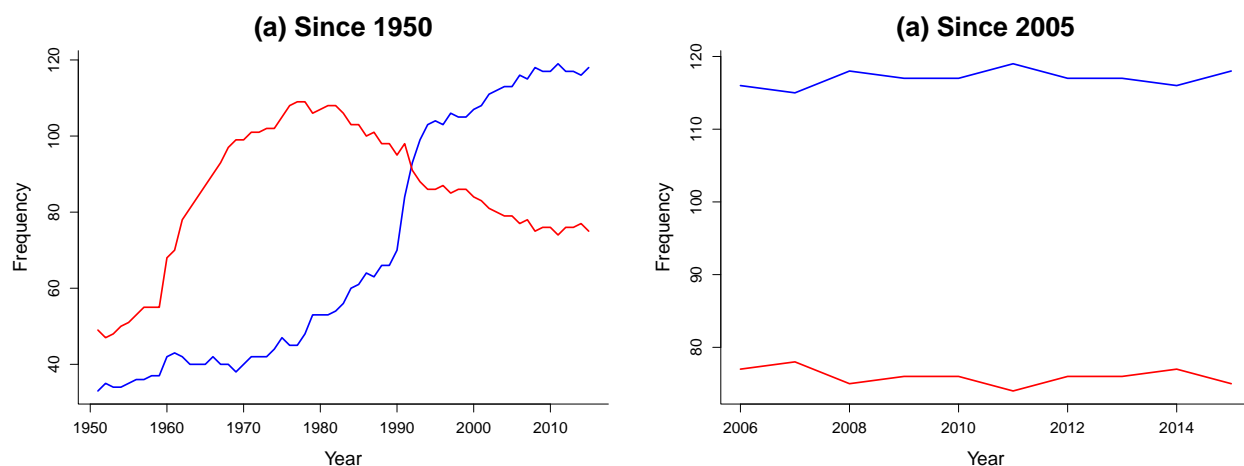


FIGURE 2. Evolution in the number of democracies from 1950 and 2005.

<sup>4</sup>There may be a certain degree of coder bias in the V-Dem measures, which are scored retrospectively, but broadly accurate patterns can be gleaned from these scores.

What is democratic erosion? Part of the problem is that, at least among developed economies, backsliding is a novel phenomenon. As such, its theoretical boundaries are fluid. Lust and Waldner (2015) define it as “a change in a combination of competitive electoral procedures, civil and political liberties, and accountability.” Adopting a minimalist approach, focusing only on elections, cannot help describe the myriad ways in which incumbents attack the liberal aspects of democracy (Zakaria 2011). Adopting too expansive a view of democracy would lead to the conclusion that no democracies are such in the first place. I share Lust and Waldner’s (2015) ‘middle ground’ approach, as it helps us analyze democratic erosion in terms of both procedures as well as civil and political liberties.

One thing is common across backsliding democracies: elections remain mostly free. Cases of voter intimidation exist but are few and far between, and the vote is secret. Votes are tallied up truthfully and electoral fraud is virtually nonexistent. Indeed, it has become rare to steal elections on election day (Bermeo, 2016). However, elections are increasingly less fair. Incumbents are using their power to capture the process around elections, or what Bermeo (2016) calls ‘strategic manipulation’. Incumbents seek to tilt the playing field in their favor, using the media, government funds, or intimidation of the opposition as tactics. In the contentious Catalan elections of December 2017, which came in the wake of a controversial independence referendum in October, the Spanish government used its executive powers over the region<sup>5</sup> to tilt the election in favor of unionist parties. Pro-independence parties had little or no access to advertisements on media outside regional outlets, which were in turn banned from broadcasting any event, organized by political parties or civil organizations, that had a pro-independence message. Prime political advertisements in Catalonia Square in Barcelona’s center were reserved exclusively for unionist parties, which in turn had 1.5 times the budget of their rivals despite only having 36 seats in the Catalan Parliament —to the pro-independence coalition’s 72. Moreover, Catalonia’s two most influential political figures, Oriol

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<sup>5</sup>As a result of the application of Article 155 of the Spanish constitution, the conservative government of Mariano Rajoy took full control of Catalan institutions on October 27, 2017. The region had until then been ruled by a pro-independence coalition that won the September 2015 elections.

Junqueras and Carles Puigdemont, were unable to campaign: the former was jailed without trial on November 2, while the latter avoided jail and fled to Belgium and then Germany. Both countries refused to extradite him back to Spain on armed rebellion charges, which carry a prison sentence of 30 years.

An important aspect of defining the recent downtrend in democracy as ‘erosion’ instead of breakdown is that we can judge what is happening irrespective of its outcome for democratic survival. This is especially important in advanced democracies with strong institutions, as incumbents require time and effort to subvert democracy. Incumbent takeovers (Svolik 2018) as a form of democratic breakdown exist but are rare, precisely because it is difficult to determine when the process is complete. In Poland, for instance, Duda’s ruling right wing Law and Justice Party (PiS) has sought to reorganize the country’s court system, reducing judicial independence and increasing the party’s influence over key institutions such as the constitutional court. In July 2017, Parliament passed a law that effectively dismissed all justices on the constitutional court not appointed by Duda. Met with fierce public protests, Duda vetoed the bill, but a new one was introduced in December 2017 lowering the justices retirement age to 65 from 70, forcing 21 members, including its Chief Justice, to step down. It also created a disciplinary committee for the constitutional court, which could be used by the PiS to intimidate judges. Thus, defining *attempts* at a takeover is also complicated, as we do not know the real motivations of suspicious incumbents such as Trump or Duterte. What we can indeed observe is the fact that democratic quality is decreasing, and that is usually accompanied by the rise of a political opportunist that concentrates power in his hands.

#### SHOCKS, ECONOMIC INEQUALITY AND THE RISE OF A POLITICAL ENTREPRENEUR

The economic shock of 2008 had broad repercussions for developed democracies. Inequality rose to unprecedented levels, primarily because wealth accumulated in the elite at the fastest rate since the late 1800s (Piketty 2014). Economic growth was slow in Europe during the recovery and faster in

the US. In general, however, growth slowed in the period 2008-2018 as compared to the previous decade. New wealth accumulated to the richest individuals in society and the middle class felt the economic squeeze through higher unemployment and stagnant salaries. They are worse off in purchasing power today than before the crisis.

Moreover, the 2008 recession came at a time of deep transformation in the global economy. Emerging markets have concentrated production for industries that used to be based in developed economies, offering higher productivity levels and cheaper costs. Since the turn of the new millennium, globalization and technological progress have shifted the productivity spectrum, with high value added in services, technology and advanced financial management, and low productivity in industry, manufacturing, and mining. The shift had visible consequences for communities that, for years, had relied extensively on the latter. Industrial and manufacturing jobs disappeared as industries settled in emerging markets; retirement plans tied to stock prices, such as General Electric's, lost half or more of their value. The 2008 crisis compounded on these issues, accelerating the deterioration of these communities through the loss of property values and widespread foreclosures. The sense of loss that follows a crisis or a period of deep transformation fostered political discontent, primarily in communities where low productivity sectors are located and the consequences are more visible. Indeed, the rise of unemployment was marked in areas where populist movements, from the left or the right, gained the most ground. It was also where traditional parties or candidates were hit the hardest.

The discontent brought on by economic transformation and loss creates an opportunity for the rise of a political entrepreneur. Traditional parties have difficulty capturing these voters because they are accustomed to building broad coalitions that include a large portion of moderate voters. With the belief that losing moderate voters is the death knell of any political campaign, these parties are slow to react to a rapidly changing political landscape. On the other hand, new, alternative candidates have an opening to capture these voters' support by way of a new political brand that



promises credible change. Not all succeed, but the ones that do establish a base of support through on which they can build for future election cycles (cite).

Why do some political entrepreneurs develop an intent to subvert the system and take power for themselves, i.e. become Caesarian candidates? Indeed, the 2008 crisis and its aftermath has led to a proliferation of Caesarian leaders in advanced democracies, with Trump in the US and Duda in Poland as standard-bearers. These candidates or leaders use personal charisma or prestige as outsiders to gain the popular favor of the masses and accumulate power in their hands once they take office.

I argue that deep crises like the Great Recession merge economic malaise with a profound lack of belief in the system by voters, who blame it for bringing on the crisis. Traditional political candidates and elites lose the faith of many voters, who begin to blame them for their travails. Outsider candidates who champion democracy as is are less likely to woo these supporters. Fiery anti-establishment candidates, on the other hand, hit this nerve forcefully and are able to build solid coalitions around this message. When economic troubles are the result of regular economic cycles or external shocks for which foreign countries can be blamed, democracies (and political systems in general) are better able to cope with discontent. For instance, one of the reasons Cuba survived the special period in the early 1990s was that the leadership was hardly at fault for the fall of the Soviet Union. It was surely to blame for creating the alliance in the first place, but not for the fall. It was easier for the leadership to distance itself from the cause of the crisis and sell a message of unity and perseverance against adversity.

The 2008 crash is, in many ways, the great failure of regulation and, to a lesser extent, of democracy. It was perceived as a domestic issue in many countries, even though the crisis originated in the US. Banks suffered globally because of their lax lending practices, and bailouts were required in a majority of developed democracies. Bailouts, and the perception that the rich got off unscathed and became even richer, were particularly harmful to people's view of democracy. In Spain, Bankia

and other smaller institutions were rescued through a private-to-public debt conversion mechanism orchestrated by the European Central Bank. Public debt ballooned from 50 percent to 100 percent of GDP within one year. Bankia's case was particularly harmful, as it cost taxpayers 23 billion euros and the perception was widespread that the bank paid few costs for its malpractice.<sup>6</sup>

This lack of belief in the system generates an opening for a new leader to propose strong leadership to replace the weak and greedy political class; in essence, to offer voters less traditional democracy in exchange for a potentially better future. Promises to rid the state of corruption, replace the political elite, improve economic prospects with large-scale reform, are common threads in these emergent leaders. Explicit voter support for these positions paves the way for them to take office and accumulate power in their hands in a way that previous leaders could not.

#### ECONOMIC ELITES AND WHY CAESARIAN LEADERS TRIUMPH

Once Caesarian candidates have built a coalition of voters that can challenge in an election credibly, they require elite support to win. Elites, however, are usually loathe to give it precisely because these leaders are independent, unpredictable, and often espouse an anti-establishment message. As the case of Podemos in Spain shows, it is difficult for alternative candidates to win office and subvert the system if elites present a united front against them. In other cases, candidates have been victorious partly because a set of favorable elites has supported them or, at least, allowed them to win. Why would elite groups support such a candidate?

I argue that support from the elite is driven by the degree of polarization in the *economic elite*. Classic works by Linz and Stepan (1978) and Bermeo (2003) identified elite polarization as the central mechanism for twentieth century democratic breakdowns in Europe and Latin America, but their accounts in fact reflected divisions among the *political elite*. Recent work by Svobik (2018) focuses on the role of voter polarization in democratic backsliding. He argues that highly polarized

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<sup>6</sup>Adam Przeworski points out that "something is wrong when a plurality of citizens in a democracy, asked which institutions have most power in their country, answer 'banks.' Access of money to politics is the scourge of democracy" (Przeworski 2016). He was referring precisely to the case of Spain, where a survey found that 32 percent of citizens considered banks to be the most powerful institutions, followed by government at 26 percent.

voters will opt for a candidate that fulfills their policy preferences over a more democratic candidate that does not. However, considering the growing importance of money in politics and the crucial role of democratic institutions in managing the diverging interests of economic elite groups, a renewed emphasis on the motivations of the economic elite may yield important insights into democratic erosion.

Economic elites are highly polarized when important subgroups cannot accept the electoral victory of another group. In normal times, they may rue another group's triumph over theirs, which occurs frequently in democracy. But when polarization is high, they cannot tolerate it. This is precisely what has occurred in the US, where a subset of the conservative elite decided it could not accept the victory of the Obama-Clinton coalition in 2016, whatever the cost. Whether these groups' beliefs are substantively justified is beyond the point; to them, the Obama coalition and its debt-inducing policies, with universal health care at the forefront, was an existential threat. Trump capitalized on this polarization to obtain the necessary backing of an elite group that saw him as the redeemer of the conservative cause after Obama (cite).

In Spain, the rise of Podemos in late 2014 and early 2015 led to a delicate balancing act by established economic elites. Podemos at the time were on the far left, inspired by the popular protests of the 15th of May, 2011 and the movement they spawned. The party shot up in the polls, becoming the favorite to win the national elections in most surveys around November 2014. An *El País* poll had them ahead of the socialists at 27.7 and 26.2 percent of the vote respectively. The right-wing Popular Party's share decreased from 44.6 in the 2011 elections to 20.7 in that same poll. Another survey in January 2015 revealed that they would beat the Popular Party in the general election by 3 points. At the time, Podemos spoke of nationalizing industries and drastic increases in taxes on the rich to revert the post-crisis fortunes of a battered middle class. The rise of an alternative, populist party put all elite sectors on alert, and very few if any supported Podemos. Rather, a majority of elites saw the need for a new conservative party to compete against Podemos

and replace the traditional Popular Party, whose corruption scandals were only adding fuel to the populists' fire. As a consequence, many established elites threw their support behind Ciudadanos and Albert Rivera, a party built around two core concepts: rid the state of corruption and defeat the nationalists movements in the Basque Country and, more importantly, Catalonia. As of mid-2018, Rivera is leading in the polls (cite).

Thus, both in the US and in Spain, conservative elites at one point in time faced the prospect of an intolerable opposition triumphing in an election. The rhetoric in conservative circles, misguided or not, was that the Obama-Clinton coalition or the Podemos coalition would wreak havoc on taxes, jobs, the national debt, and investment. It would lead to greater centralization and bigger government, through nationalization (Spain) or greater debt, climate change policy, and universal health care (US).

#### WEALTH, THE PRODUCTIVITY GAP, AND ELITE POLARIZATION

What makes elites polarized to the extent that they are willing to accept an alternative candidate who defends certain anti-democratic and anti-establishment positions? Following Przeworski's idea that money in politics tends to undermine democracy, I contend that a particular type of cleavage in the *economic* elite fosters the rise of Caesarian leaders that undermine democracy: the productivity gap.

The basic idea around the productivity gap is that certain groups whose capital is tied to low productivity sectors turn to the state for rent-seeking. Conversely, groups in high productivity sectors continue to accumulate new wealth through innovation, and require only favorable trade and monetary policy to continue expanding. The productivity gap among economic sectors, therefore, generates divergent trajectories for their long-run wealth accumulation. High productivity sectors can expect high returns in the future, and thus their expectation is that they will be much wealthier

down the line. Low productivity sectors are generating little new wealth from their capital investments. Low returns now and in the future translate into an expectation for decreasing wealth and influence on policy.

It is useful to think of this elite choice in game theoretic terms. Elite groups must consider two broad states: the present state and some future state. Two main considerations exist in these two states. First are returns to wealth and the second is policy influence. For low productivity sectors, the present state is comprised of low returns on wealth, as defined precisely by their low productivity. However, their political clout is still high, given the important position they occupied in the economy for so long, their high current wealth, the number of people they employ, and the lobbying connections they developed over time. The future state, on the other hand, promises to be lower on both fronts if productivity stays low.

For high productivity sectors, the picture is reversed. They have high levels of productivity but exercise less political influence in the present state; these groups tend to be the result of innovation and technology shocks and are thus newer, with a less well-developed lobbying infrastructure. However, they expect their wealth and political clout to be higher in the future provided their productivity stays high.

The diverging productivity paths for both groups affect their political calculus in the present time. Low productivity sectors have to choose between the status quo or seeking alternative ways to generate income and compensate for the low returns on their capital. High productivity sectors face a similar choice, i.e. status quo or find alternative ways to generate capital and maintain power, but their large gains in the present and high expectations for the future eliminate any incentive they may have to depart from the status quo.

Low productivity sectors, on the other hand, are less convinced about the status quo. All else equal, they would rather remain in a democratic system in which they have full guarantees on their property against the whims of an autocrat. But they see their social and economic position so

threatened in the future state that they need to seek alternatives. Reinvesting capital into more productive enterprises is one option. If the productivity gap is large, new investments will require a long time to produce sufficient returns to close the gap, and there is no guarantee that the gap will close. Another alternative is to take over the state and rent seek.

Economic elites in democracy prefer to seek rents from the state when their payoff from doing so in the future state is higher than investing in more productive assets. If they consider that they will benefit more from rent-seeking than productive investments in the future, low productivity groups seek to capture the state in the present period. This is contingent on their ability to do so, but their greater political influence in the present time enables them. Indeed, an added incentive to capture the state early is to have a first-mover advantage in reallocating money and taking control of the coercive apparatus. Thus, one can think of a continuum along which low productivity elites decide whether to support a democratic candidate or one that helps them rent seek, as a function of their current ability to influence the system. As low productivity makes a dent in these groups wealth, political influence decreases and they no longer possess the ability to influence the system. Their optimal strategy is to capture the state and rent seek before they lose the ability to do so if they expect to gain more from rent-seeking than productive enterprises in the future.

#### WHY CAESARIAN LEADERS SUBVERT DEMOCRACY

A high productivity gap provides incentives for some economic elites to take over the state and obtain rents. However, these elite groups continue to face two issues: a collective action problem, which stems from the doubts that certain elements may harbor about directly subverting an established democratic system; and uncertainty over the outcome. I contend that Caesarian leaders emerge to solve these two problems and provide low productivity elites with a political platform to obtain state rents.

Caesarian leaders gain power by exploiting the situation created by greater elite polarization and offering one group of elites certain policy concessions. Their rhetoric is often pro-democracy

as much as Caesar's was pro-Republic. The latter famously stated that he only established his Emperorship in order to fix the Republic's ills, but that it was his intention all along to restore the Republic as soon as he could. Modern strongmen follow a similar tactic: they claim to be the only leaders suited to save the system from itself, but find themselves concentrating greater power and undermining democracy once they win office. Established elites, faced with the prospect of an unacceptable opposition triumph or a Caesar, choose the latter.

So far I have argued that polarization in the economic elite through a large productivity gap facilitates the emergence of a Caesarian leader, who capitalizes on popular discontent. But we need more clarity as to why these leaders, once in power, subvert democracy. Character and personality certainly play some role, and it is no coincidence that candidates with weaker democratic convictions emerge in times of crisis, as I argued before. However, I contend that there are two structural factors that drive incumbents to take over democracy: (1) the platform that allowed the leader to rise is built precisely in such a way that the leader accumulates power and enacts vast reform and (2) worries about post-tenure legal troubles.<sup>7</sup>

First, political opportunists that emerge in a post-crisis scenario tend to espouse anti-establishment rhetoric because rallying against the establishment wins votes. These challenges, however, require that these candidates make grandiose promises of reform. The system must be changed wholesale, not piecemeal. Candidates raise the stakes to such an extent that, should they win office, they must follow through on at least some of the more notorious promises. Quick, wholesale reform is not possible within the bounds that strong democratic institutions place on elected officials. Shortcuts are needed, and these shortcuts are precisely what erodes democracy. I will go into these shortcuts in detail in my case studies.

Another important and often overlooked reason why leaders have a necessity to fully subvert the system once in office are preoccupations regarding their legal status after they leave office. These leaders are likely to have committed certain illegalities either to reach power or to achieve

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<sup>7</sup>Joe.

meaningful reform. While in office, they are faced with a choice to subvert the system to the point that they can control reelection or, at least, maintain a faithful following in the top echelons of the state apparatus, or place themselves at the mercy of the opposition if the latter triumph. In this situation, Caesarian leaders stay the course and continue to subvert democracy as much as they can to ensure their freedom and the safety of their wealth once they leave office.

## EMPIRICAL ANALYSIS

Quantitative evidence is presented first, with tests for democratic erosion and breakdown. Two case studies, on the United States and Spain, follow.

## DATA

The primary hypothesis is that, in democracy, high levels of inequality and a growing productivity gap among economic sectors lead to democratic erosion. To test it, valid measures of economic inequality, elite wealth, and democracy are required. For the latter, I use V-Dem's continuous measure of liberal democracy to probe whether wealth inequality and accumulation interact to produce democratic backsliding.

I use two measures of economic inequality. First, I use the share of capital that accrues to labor (wage share - WS), which captures cross-class differences between capital-holders and labor. This variable is more fitting to theories that focus on inter-group inequality and class cleavages (Boix, 2003; AR, 2006; Houle, 2009). The higher the share of output that accrues to wages, the more *equal* the society. The measure is taken from the INDSTAT2 dataset produced by the United Nations International Development Organization (see Knutsen, 2015).<sup>8</sup> For the results to be intuitive, I have inverted the WS variable. Now the greater the variable's values, the higher the level of inequality—it captures, in essence, the share of output that accrues to capital holders, a concept also by Houle

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<sup>8</sup>The dataset can be found at <https://stat.unido.org>.



(2009, 2016). I use data for advanced democracies from the end of the cold war until 2008 –the last year for which data are available.

Another widely used measure of inequality is the Gini coefficient, which captures the distance between the largest and smallest individual incomes in society. I use Solt’s (2016) adjusted Gini index, which is one of the few measures to capture inequality levels in advanced democracies until 2017. This compensates for the fact that WS data is available only until 2008, and thus misses the period in which we have observed the greatest amount of democratic backsliding. More information about this variable is included in Appendix A1.

I use productivity data from the OECD to estimate the productivity gap among sectors. Data are available for the following sectors: finance, information and communication, professional services, and retail are classified as high productivity sectors that fall under the broader ‘business excluding agriculture’ umbrella; and industry, manufacturing and mining which are group under industrial sectors. I compare the aggregate productivity of these two broad sectors, business services and industry. I use data available from the end of the cold war until 2017.<sup>9</sup> To create the final productivity gap measure, I calculate the difference in productivity between business services and industry for each observation (the unit of observation is the country year).

## METHODS

Tests for democratic erosion use V-Dem’s continuous democracy measure. I use random effects OLS models to leverage both within- and between-variation across different countries. The main models are country random effects with clustered standard errors,<sup>10</sup> with year and region fixed effects. I also present the analysis using only OLS models with fixed effects.

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<sup>9</sup>A majority of countries have data only up to 2015.

<sup>10</sup>Clustering is important in both random and fixed effects because nonrandom selection and treatment continue to affect the standard errors substantially (Abadie et al., 2017).

## RESULTS

Table 1 presents the results for the effect of the productivity gap on democratic erosion, conditional on levels of inequality as measured by the WS. Models 1 through 3 show the results for the full sample, which includes all democracies irrespective of their VDem score. Models 4-6 include advanced democracies only. The subsample in the latter models includes countries with a V-Dem score greater than 0.8: Australia, Austria, Belgium, Canada, Chile, Costa Rica, the Czech Republic, Denmark, Estonia, Finland, France, Greece, Ireland, the Netherlands, New Zealand, Norway, Poland, Portugal, Sweden, the UK and the US.<sup>11</sup> The differences are stark, primarily in the interaction term between the productivity gap and inequality. The effect of greater differences in productivity as inequality increases is slightly negative and not statistically significant for the full sample, but it becomes steeply negative and statistically significant when we include only the subset of advanced

	(1)	(2)	(3)	(4)	(5)	(6)
Prod. Gap	0.174 (0.628)	-0.029 (0.160)	0.084 (0.200)	0.808*** (0.154)	0.311*** (0.106)	0.433*** (0.113)
Inequality (WS)	-0.001 (0.006)	0.001 (0.001)	0.000 (0.002)	-0.001 (0.003)	-0.001 (0.001)	-0.003 (0.002)
Prod. Gap $\times$ Inequality (WS)	-0.030 (0.143)	-0.001 (0.031)	-0.017 (0.044)	-0.138*** (0.031)	-0.056*** (0.020)	-0.079*** (0.023)
GDPpc		0.002* (0.001)	0.004* (0.002)		0.003** (0.001)	0.006** (0.002)
Growth		-0.000 (0.000)	-0.000 (0.000)		0.000 (0.000)	0.000 (0.000)
Oil Prod.		0.001 (0.000)	-0.001 (0.001)		0.002*** (0.001)	0.001 (0.001)
VDem Lag		0.953*** (0.012)	0.828*** (0.042)		0.728*** (0.057)	0.581*** (0.043)
Constant	0.760*** (0.025)	0.021 (0.016)	0.096** (0.039)	0.836*** (0.015)	0.205*** (0.046)	0.309*** (0.045)
Observations	499	474	474	249	243	243
Ovr. $R^2$	0.051	0.983	0.980	0.247	0.906	0.854

TABLE 1. Effect of the productivity gap and inequality on democratization

<sup>11</sup>A score of 0.8 represents the median score for the sample.

democracies. In Models 4-6, greater elite wealth as inequality increases significantly decreases the predicted V-Dem score for a given country.

Figure 3 displays the results from Table 1 substantively. Plots (a) through (d) show the marginal effects of increases in the productivity on the V-Dem score at different levels of inequality. For all democracies, the effect is weakly negative and is not statistically significant at any level of inequality, both the the random effects –plot (a)– and fixed effects –plot (c)– specifications. In the subsample for advanced democracies only, however, the effect is sharply negative and statistically significant for countries with high inequality, consistent with Table 1. In plot (b), as inequality increases in an

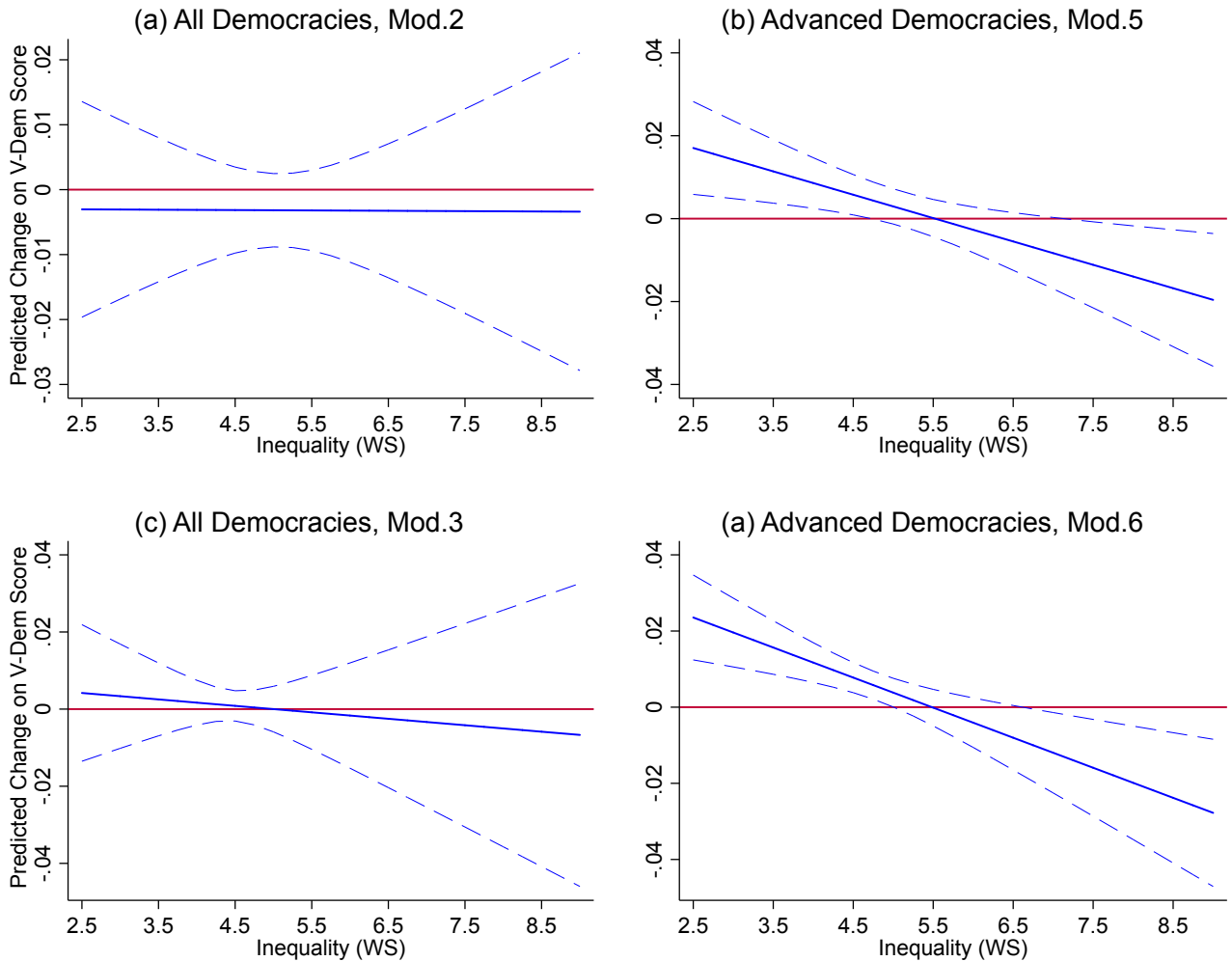


FIGURE 3. Effects of the productivity gap on democracy conditional on inequality.

advanced democracy, any one unit increase in the productivity will produce a substantive negative change in the V-Dem score. For instance, an advanced democracy with inequality levels at 7.5 will see its V-Dem score decrease by 0.012 units for each unit increase in the productivity gap. In the sample for advanced democracies, the V-Dem score ranges from 0.8001 to 0.8922, so a decrease of 0.012 represents a 13 percent change in the dependent variable. If the productivity gap increases from 1 to 3, the loss in the V-Dem score grows to 0.024, or 26 percent.

In plot (d), the model with country fixed effects, the interactive effect of differences in productivity and inequality is even starker. A one unit change in the productivity gap at high levels of inequality (7.5) will produce a decrease of 0.016 in the predicted V-Dem score. A two unit will lead to a loss of 0.032 in the value of democracy. These figures represent, respectively, a 17.4 and 34.7 percent change within the range of the V-Dem score in the sample. The results are consistent with country-specific evidence: for example, the US peaked at 0.88 in its V-Dem score in 2012, and decreased to 0.83 in 2016, a substantive decrease that is similar to the one predicted by the model.<sup>12</sup>

Results obtain if we use Solt's Gini index measure of inequality, which extends until 2017, as shown in Table 2. For the full sample of democracies, the effect of the productivity gap on democracy is positive as inequality increases, as the interaction term shows. It is statistically significant at the 0.1 level for the two fully specified models (1 and 2). However, as with the results in Table 1, the sign of the relationship reverses when only advanced democracies are included in the sample. For these countries, as inequality increases, a larger productivity gap leads has a negative and statistically significant effect on democracy –models 4-6.

#### WEALTH INEQUALITY AND DEMOCRATIC EROSION IN SPAIN

Democratic declines in Europe are apparent: since 2012, a majority of countries have suffered a regression in their democratic quality. Figure 4 displays the evolution of V-Dem scores for the UK,

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<sup>12</sup>Again, remember that the inequality measure using WS is only available until 2008, but the predictive power of the model is consistent with events that occurred after the crisis. I use Solt's measure to produce results that are time-consistent with the events of the past decade.

	(1)	(2)	(3)	(4)	(5)	(6)
Prod. Gap	-0.078 (0.103)	-0.063** (0.032)	-0.049* (0.026)	0.166*** (0.052)	0.096** (0.047)	0.110* (0.054)
Gini Market Income	0.182 (0.227)	-0.034 (0.023)	-0.013 (0.064)	0.198*** (0.053)	0.011 (0.020)	0.050 (0.057)
Prod. Gap $\times$ Gini Market Income	0.175 (0.218)	0.126* (0.068)	0.098* (0.056)	-0.348*** (0.110)	-0.205** (0.104)	-0.234* (0.119)
GDPpc (log)		-0.001 (0.001)	-0.004 (0.003)		0.002*** (0.001)	0.003 (0.002)
growth1		-0.000 (0.000)	-0.000 (0.000)		-0.000 (0.000)	-0.000 (0.000)
vdemlib1		0.972*** (0.022)	0.872*** (0.037)		0.676*** (0.055)	0.485*** (0.053)
Constant	0.669*** (0.110)	0.054*** (0.017)	0.147*** (0.035)	0.760*** (0.025)	0.257*** (0.047)	0.392*** (0.039)
Observations	899	867	867	238	235	235

TABLE 2. Effect of the productivity gap and inequality on democratization using Solt's Gini.

France, Denmark and Spain. All countries decline after 2012, two of them to the lowest levels since 1995 – Denmark and Spain. France is close to its 1995 score after dropping by almost 7 percent since the election of Francois Hollande. The UK has decreased 11 percent since 2012, and Spain's V-Dem score of 0.7 puts it on par with France, the UK or Ireland in the 1960s.

My theory predicts that an inequality shock provides an opportunity for a political opportunist to obtain popular support and attempt to take power, but that elite support is required to win a general election. Elites support an outsider when levels of elite wealth are so high that groups believe they can obtain their preferred policy from government and no longer need to compromise. This increases polarization among the economic elite, who prefer a less democratic candidate over the victory of the opposition. A Caesarian leader exploits this situation to obtain both popular and elite support, win an election with a certain probability, and subvert democracy once in power.

The case of Spain is a good example of when the lack of elite support prevents a populist, potentially Caesarian leader from emerging. This shows precisely why the second stage of my argument, elite polarization through high levels of wealth, is so important in fostering or hindering

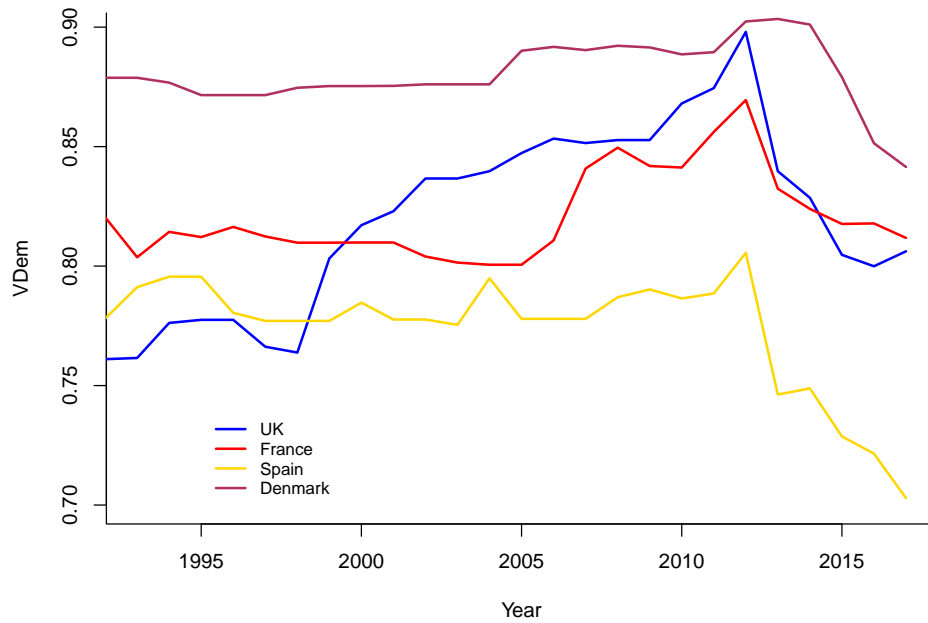


FIGURE 4. Evolution of V-Dem scores by country since 1995.

democracy. Spain suffered a double crisis between 2008 and 2010. First, the housing bubble began to burst in late 2007 after years of rapid growth. The ECB had maintained interest rates low at 2 percent from 2003 to 2006 to help Germany recover from its recession. With growth at over 4 percent for the period, Spain's economy overheated through the housing market, as banks borrowed cheap money from the ECB and packaged it into easy to obtain loans for consumers. This left banks over-leveraged and consumers unable to pay back their mortgages after the bubble burst and the effects of the Great Recession began to be felt. The recipe for recovery by the ECB were cuts in public spending, labor market reform, and the nationalization of private bank debt.

These reforms cut deep into the middle class' pockets and clawed back some of the welfare gains that had been made since the advent of democracy in 1978. The discontent erupted into large scale protest on May 15, 2011. Millions of citizens marched onto the streets in the country's main cities and occupied the main squares for months. The movement coalesced around a new political party, Podemos, founded in January 2014 under the charismatic leadership of Pablo Iglesias. At inception,

the party espoused radical left wing views, some of which were hotly debated. Among these were the nationalization of large corporations in the energy sector, a large increase in the minimum wage, and a guaranteed minimum income. Its discourse was overtly anti-establishment, popularizing the concept of *la casta*<sup>13</sup> to describe established elites who, in their view, had ran the country to the ground.

The party first burst onto the scene in the May 2014 elections to the EU parliament, just three months after it was created. It won 5 seats and 8 percent of the vote, finishing fourth. General elections loomed in late 2015, and it appeared that Podemos would sweep into power. Polls in late 2014 and early 2015 had them comfortably ahead of established parties like the conservative Popular Party (PP) and the socialist PSOE. Pablo Iglesias was the most popular leader in the country, had constant media presence, and the sense was that he would become, in all likelihood, the next president.

However, Podemos' project attracted few elites. Promises to nationalize large corporations were particularly harmful to build an elite coalition, as they increased uncertainty around which companies would be placed on the state's books should the party govern. Large-scale wage redistribution became one of Podemos' core messages, but few elites warmed up to the idea of a substantial increase in costs. The party's elite connections were also initially weak. Pablo Iglesias was a university professor before his switch to politics, and most of the executive committee came from similar non-elite backgrounds. Most were university professors, researchers, and activists. Among the first representatives Podemos sent to the European Parliament were a high school teacher, a small business owner, and a researcher, all of whom had no previous experience in politics.

In essence, Podemos represented the low productivity working class who suffered the brunt of the economic readjustment imposed by the European Union after the financial crisis. Thus, its appeal was based on a logic of class struggle, in which low productivity workers from the middle

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<sup>13</sup>Casta refers to pedigree, to aristocracy, to the elite, and also to chastity and purity. Podemos popularized it as a pejorative label for established elites.

and working classes saw their wages slashed and social benefits cut as elites sought to create a leaner and more productive economy. Elites, however, were united in how they approached their future wealth generation and the role of democracy in that process. No industries were obtaining the ultra high productivity margins of US technology corporations, and all were more or less affected by the double set of crises that affect the Spanish economy – the housing crash of 2007 and the global financial crisis of 2008. Banks were particularly weakened by large amounts of toxic mortgages handed out during the 2003-07 boom. Realignment was inevitable, and an entire network of local and regional savings banks were dismantled or absorbed by national banks after large bailouts. A majority of the country's top banks required assistance, with Bankia's 23 billion bailout package the most conflictive of all. To a lesser extent, La Caixa (now CaixaBank) and Banc Sabadell also required assistance, and only Banco Santander navigated the crisis relatively unscathed.

Large Spanish construction corporations were heavily affected by the housing crisis and the temporary slowdown in public projects in the years that followed. National utility and telecom corporations, such as Telefonica or Gas Natural, continued to enjoy dominant market positions that would continue no matter the party in power. Clothing giants like Inditex (known for their Zara brand) and Mango had their sights in the global market and looked at Spanish politics with relative disinterest. Thus, perhaps in part because the housing crisis had ripple effects on almost every part of the economy, there was no obvious elite cleavage that Podemos and its Caesarian candidate, Pablo Iglesias, could exploit.

Elites, however, did see the danger that he posed should he obtain sufficient electoral support to govern –or at least wield influence within a multiparty coalition government. To prevent this, elites presented a united front and used the tools in their disposal to stop Podemos from rising further. Established political elites contributed to this. Socialists were particularly weary of Podemos, who were agitating their core base of supporters and threatening to win them over. Conservative elites saw Podemos as an outside movement that threatened to break up the constitutional order, which



had long been upheld by the traditional parties, PP and PSOE. It certainly did not help matters that Podemos was unapologetically republican, and in multiple occasions intimated that the royal family should be removed from their ceremonial office. National newspapers from the left and the right equally attacked or ignored Podemos, as did all television outlets except, to some extent, La Sexta. The media were particularly keen on the romantic and practical attachment that some members of Podemos had with Venezuela. Iglesias' personal admiration of Hugo Chavez and Fidel Castro was duly reported and debated ad nauseam. The beginning of the end for Podemos' meteoric rise were multiple allegations against Juan Carlos Monedero, who at the time was the party's most influential member after Iglesias and his number two, Iigo Errejón. On January 27, 2015, with Podemos leading the polls, El País alleged that Monedero's academic background and degrees were false, and even reported that professors he cited as references claimed not to know who he was. The accusation was recanted by the newspaper just three days later. Then, on January 28, came the most damning report: Monedero had received payments from Chavez's government and other ALBA countries, for consulting services. Monedero resigned in March, 2015, from his post within the party.

#### WEALTH INEQUALITY AND DEMOCRATIC EROSION IN THE UNITED STATES

[Pending; See vignette for now.]