Political economy of institutional reforms: Lessons from post-communist transition

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Political economy of institutional reforms

1. Transition experience through the lens of political economy of reforms
   • Interactions of political and economic institutions
   • Inequality vs. inequality of opportunity
   • Governance, corruption and trust in institutions
   • Role of openness and external anchor

2. Implications for other reforming economies
Big picture: what worked

Transition is a comprehensive institutional change

• Replaces inefficient institutions hence should eventually raise living standards
• But involves major disruptions

Success stories

• Initial recession short-lived
• Reforms delivered broad-based income growth
• Democratic institutions consolidated
• International integration brought investment and competition
What went wrong in other countries?

**Populist backlash**
- Due to decline in living standards for the majority
- … and unfairness of the system

**Reversal of political and economic reforms**
- Populists remove checks and balances and entrench themselves
- Do not promote rule of law, openness and competition
- In order to prevent empowerment of independent middle class
The ugly face of failed transition

“Institutional economies of scale”
- Large businesses have disproportionate access to courts and politicians
- … and disproportionate access to the media

Vicious circle of crony capitalism
- Access to courts, politicians and media results in rents in the oligarchs’ business empires
  - The rents are then reinvested into political influence
  - Oligarchs hence outperform firms without political connections
- Politicians use oligarchs contributions to deter political competition
  - Through bribing or censoring potential challengers
Reformers’ mistakes

- Indecisive and partial reforms
  - Protracted transformational recession
  - Increased rent-seeking opportunities

- Unfair distribution of burden of reforms
  - Lack of social safety nets
  - Delayed macro stabilization: disproportional burden of inflation on the poor and middle class

- Corruption
  - Undermines credibility and legitimacy of reforms

- Lack of communication
  - Should have produced realistic expectations
  - Was easier for the EU accession countries
Main lessons for reformers in developing and advanced economies

<table>
<thead>
<tr>
<th>Inclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Compensate losers right away</td>
</tr>
<tr>
<td>• &quot;Short-term pain, long-term gain&quot; scenario may fail</td>
</tr>
<tr>
<td>• Populists take over and entrench themselves</td>
</tr>
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<table>
<thead>
<tr>
<th>Fairness</th>
</tr>
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<tbody>
<tr>
<td>• Level playing field, rule of law</td>
</tr>
<tr>
<td>• Integrity, transparency, and accountability</td>
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<table>
<thead>
<tr>
<th>Democratic institutions</th>
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<tbody>
<tr>
<td>• Prevent emergence of crony capitalism</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>External anchors and openness</th>
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<tbody>
<tr>
<td>• Reinforce competition and commitment to reforms</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Communication</th>
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</thead>
<tbody>
<tr>
<td>• Provides a clear vision of the reform path</td>
</tr>
</tbody>
</table>
Supporting evidence
**Big picture: Empirical implications**

Cross-country differences

- Countries that build inclusive political institutions, also manage to reform
- Countries without democratic institutions end up with crony capitalism
- Strong correlation between democracy and economic reforms
- EU accession facilitates both political and economic reforms

Within countries

- Burden of reforms: disproportionally on less skilled
- Corruption and inequality of opportunity reduce support for reforms
- In non-democratic countries
  - Oligarchs outperform others
  - Critical attitude to government among more skilled
  - Skilled also understand the presence of media capture and censorship
Measurement

Market reforms
• EBRD’s Transition Indicators
  • From 1 (command economy) to 4 or 4+ (market economy)

Governance
• Average of four Worldwide Governance Indicators
  • Rule of law
  • Control of corruption
  • Government effectiveness
  • Regulatory quality
• Corruption experience from Life in Transition Survey (LITS)

Democracy
• Polity score from Polity IV dataset

Inequality of opportunity
• IoP: Part of inequality explained by exogenous factors (parental background, gender, place of birth, ethnicity, etc). Source: LITS.
Slowdown of reforms and decline of support for markets and democracy
In many countries reforms are stalled, in some even reversed

Average of 6 country-level transition indicators

Source: EBRD Transition Indicators (2014).
Support for reforms is low

% respondents supporting market economy

2016 2010 2006

Countries included in the survey:
- Uzbekistan
- Mongolia
- Tajikistan
- Kyrgyz Rep.
- Kazakhstan
- Kosovo
- Greece
- FYR Macedonia
- Albania
- Cyprus
- Montenegro
- Romania
- Bulgaria
- Bosnia and Herzegovina
- Serbia
- Turkey
- Slovenia
- Lithuania
- Poland
- Estonia
- Hungary
- Croatia
- Slovak Rep.
- Latvia
- Moldova
- Ukraine
- Armenia
- Belarus
- Georgia
- Azerbaijan
- Russia
- Transition region
- Germany
- Italy

CA
SEE
CEB
EEC
% respondents supporting democracy

- Turkey
- Uzbekistan
- Tajikistan
- Mongolia
- Kyrgyz Rep.
- Kazakhstan
- Cyprus
- Greece
- FYR Macedonia
- Kosovo
- Montenegro
- Romania
- Albania
- Bulgaria
- Bosnia and Herz.
- Serbia
- Lithuania
- Hungary
- Poland
- Slovenia
- Estonia
- Croatia
- Latvia
- Slovak Rep.
- Armenia
- Georgia
- Moldova
- Ukraine
- Belarus
- Azerbaijan
- Russia
- Transition region
- Germany
- Italy

CA
SEE
CEB
EEC

2016
2010
2006
Democracy and economic institutions
Economic institutions tend to be weak in non-EU transition countries

Sources: World Governance Indicators (2015); IMF WEO, authors’ calculations.
Democracy and economic institutions around the world

Sources: Policy IV, World Governance Indicators. Based on 2015 data.
Positive correlation in EBRD countries

Sources: Policy IV, World Governance Indicators. Based on 2015 data.
Panel analysis of the determinants of economic institutions: positive effect of democracy and of openness

<table>
<thead>
<tr>
<th>Dependent Variable:</th>
<th>Average of 4 World Governance Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Panel OLS</td>
</tr>
<tr>
<td>Polity2</td>
<td>0.0270***</td>
</tr>
<tr>
<td></td>
<td>(0.00325)</td>
</tr>
<tr>
<td>Natural Resources</td>
<td>-0.504***</td>
</tr>
<tr>
<td></td>
<td>(0.0618)</td>
</tr>
<tr>
<td>Trade Openness</td>
<td>0.261***</td>
</tr>
<tr>
<td></td>
<td>(0.0384)</td>
</tr>
<tr>
<td>Financial Openness</td>
<td>0.557***</td>
</tr>
<tr>
<td></td>
<td>(0.0527)</td>
</tr>
<tr>
<td>Income</td>
<td>0.392***</td>
</tr>
<tr>
<td></td>
<td>(0.0233)</td>
</tr>
<tr>
<td>Ethnic fractionalisation</td>
<td>-0.138*</td>
</tr>
<tr>
<td></td>
<td>(0.0785)</td>
</tr>
<tr>
<td>Distance from the equator</td>
<td>0.0100***</td>
</tr>
<tr>
<td></td>
<td>(0.00174)</td>
</tr>
<tr>
<td>Landlocked</td>
<td>-0.0348</td>
</tr>
<tr>
<td></td>
<td>(0.0378)</td>
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<tr>
<td>Ruggedness</td>
<td>-0.00248</td>
</tr>
<tr>
<td></td>
<td>(0.0144)</td>
</tr>
<tr>
<td>State antiquity index</td>
<td>0.00398***</td>
</tr>
<tr>
<td></td>
<td>(0.000682)</td>
</tr>
<tr>
<td>Transition country indicator</td>
<td>-0.419***</td>
</tr>
<tr>
<td></td>
<td>(0.0884)</td>
</tr>
</tbody>
</table>

Observations 703 538 703
Countries 122 122 122
R-squared 0.858 0.798
Adjusted R-squared 0.8531 0.7922
F-value 186.36 128.44

Source: Worldwide Governance Indicators, WTO, IMF, authors’ calculations, based on the time period 1996-2014.
International integration and democracy stand out as the major correlates of good institutions and reform.

Factors explaining institutional quality difference between top and bottom transition countries:

- Geography, history, and ethnicity
- EU membership
- Income per capita
- Natural Resource Curse
- Democracy
- Openness (trade and financial)

Source: *Stuck in Transition?*, authors’ calculations, based on time period 1996-2012.
Democratic and political change went hand in hand

Sources: Policy II&IV, World Governance Indicators, authors’ calculations.
EU accession played an important role – but a weaker anchor post-accession

Average annual change in governance indicators in EU-10 relative to accession year

Source: World governance indicators, authors’ calculations. On -2.5 to 2.5 scale; standard deviation is 1.
Stronger democratic institutions have also been associated with lower state share of employment.

Sources: Policy IV (as of 2012); Life in Transition Survey II (2010), authors’ calculations.
People strongly support trade if they benefit from it

- High-skilled individuals support their government if skill-intensive exports increase and skill-intensive imports decrease
- Opposite effect for the low-skilled

<table>
<thead>
<tr>
<th>Outcome is ➔</th>
<th>Approval of the leader</th>
<th>Confidence in national government</th>
</tr>
</thead>
<tbody>
<tr>
<td>TertiaryEduc*HighSkillExports</td>
<td>0.0303*** (0.0078)</td>
<td>0.0393*** (0.0071)</td>
</tr>
<tr>
<td>TertiaryEduc*HighSkillImports</td>
<td>-0.0769*** (0.0166)</td>
<td>-0.0930*** (0.0192)</td>
</tr>
</tbody>
</table>

R-squared 0.132 0.139
N 416994 441415
Uneven distribution of the pain of reforms
Reforms coincided with deep transition recession (-10% Czech to -60%+ in Ukraine / Bosnia)

Sources: IMF WEO, WDI, national authorities, EBRD calculations.
Who paid the cost of early reforms?

• Distributional impact of the reforms:
  • Milanovic’s “elephant” curve: income growth for different deciles of income distribution
  • Result: reforms have mostly benefitted the rich/skilled
    • Especially true for the early reform years
      • Bottom 80-90% experience substantial declines in incomes
Global experience – Milanovic’s “elephant curve” –
Lower middle class in advanced economies losing out

Relative gain in real per capita income by global income level, 1988-2008

Sources: Lakner and Milanovic (2016)
Note: Analysis based on income shares of each decile and income growth.
USA: Cumulative income growth since 1989 by income decile

Source: National authorities, Povcal database, IMF, UN, authors' calculations.

Note: Analysis based on income shares of each decile, income growth and various assumptions to fill in the gaps.
In post-communist countries: winners are in the upper deciles

Post-communist countries: Cumulative growth in income since 1989 depending on initial income

Sources: Povcalnet, IMF, World Bank, UN, and authors' calculations based on the methodology in Milanovic (2016).

Note: Calculations trace income growth of a specific decile in specific country in 1989 but not specific individuals.
Within countries: Impressive income growth on average – but gains depend on one’s place on the income ladder

Russia: Cumulative income growth since 1989 by income decile

Sources: National authorities, World Bank Povcal database, IMF, UN and authors’ calculations.

Note: Analysis based on income shares of each decile, income growth and various assumptions to fill in the gaps.
A similar pattern in Hungary

Hungary: Cumulative income growth since 1989 by income decile
A similar pattern during the Great Recession

Hungary: Cumulative income growth in 2007-12 by income decile

Sources: National authorities, Povcal database, IMF, UN, authors' calculations.

Note: Analysis based on income shares of each decile, income growth and various assumptions to fill in the gaps.
In most countries, only top 20-30 percent have experienced “faster-than-average” income growth

- Headline growth in the region corresponds to the experience of someone at around 75th percentile of income distribution
- Hence ¾ (and the median voter) experienced much slower growth

Percentiles of population with below-average income growth (1989-2016)

Majority have not experienced long-term income convergence with advanced economies – unlike in other EMs

- Income growth above G7 average only for 44%

Share of the population with income growth above/below the G7 average, 1989-2016

Impact of transition on well-being

• Analysis of income distribution does not provide a complete picture
  • Pre-reform income distribution was not fully informative due to regulated prices and shortages

• Need to study other indicators of well-being
  • Height
    • People born in hardship grow up shorter
  • Self-reported subjective well-being ("happiness")
Structural shifts accompanying price liberalisation caused significant economic hardship

- People born around the year of price liberalisation are 1cm shorter

Sources: LiTS II, Transition Report 2016-17.
The 1 cm effect is statistically significant controlling for individual characteristics, country-specific trends etc.

<table>
<thead>
<tr>
<th></th>
<th>Born in transition year</th>
<th>Born or one in transition year</th>
<th>Born in transition year</th>
<th>Born or one in transition year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Born in transition</td>
<td>-1.057***</td>
<td>-0.768***</td>
<td>-0.777*</td>
<td>-0.544*</td>
</tr>
<tr>
<td></td>
<td>(0.398)</td>
<td>(0.282)</td>
<td>(0.409)</td>
<td>(0.292)</td>
</tr>
<tr>
<td>Average of log GDP per capita</td>
<td></td>
<td>1.129***</td>
<td>1.190***</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(0.215)</td>
<td>(0.221)</td>
<td></td>
</tr>
<tr>
<td>No. of observations</td>
<td>42,853</td>
<td>42,853</td>
<td>40,854</td>
<td>40,887</td>
</tr>
<tr>
<td>R²</td>
<td>0.382</td>
<td>0.382</td>
<td>0.384</td>
<td>0.384</td>
</tr>
</tbody>
</table>

The fall in GDP alone does not explain the decrease in height.
Results confirmed when using continuous measures of speed of market reforms

<table>
<thead>
<tr>
<th></th>
<th>Born in transition year</th>
<th>Born or one in transition year</th>
<th>Born in transition year</th>
<th>Born or one in transition year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in price liberalisation</td>
<td>-0.565***</td>
<td>-0.343***</td>
<td>-0.466**</td>
<td>-0.274**</td>
</tr>
<tr>
<td></td>
<td>(0.194)</td>
<td>(0.114)</td>
<td>(0.204)</td>
<td>(0.119)</td>
</tr>
<tr>
<td>Average of log GDP per capita</td>
<td></td>
<td>1.267***</td>
<td></td>
<td>1.323***</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(0.229)</td>
<td></td>
<td>(0.233)</td>
</tr>
<tr>
<td>No. of observations</td>
<td>36,507</td>
<td>36,507</td>
<td>34,660</td>
<td>34,693</td>
</tr>
<tr>
<td>$R^2$</td>
<td>0.373</td>
<td>0.373</td>
<td>0.375</td>
<td>0.375</td>
</tr>
</tbody>
</table>
People from less-educated households affected most severely

Effect of transition on height, cm, by mother’s level of education

- Born in transition year
- 0-1 in transition year

Sources: LiTS III, Correlates of War Data, EBRD transition indicators, Gapminder, UCDP/PRIO Armed Conflict Dataset, and authors’ calculations
Yet cohorts born at the start of transition are more satisfied with life than their peers

<table>
<thead>
<tr>
<th></th>
<th>Satisfied with life (0/1)</th>
<th>Satisfaction with life (1/5)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Born in transition year</td>
<td>0.141*</td>
<td>0.148***</td>
</tr>
<tr>
<td>Born in transition</td>
<td>(0.079)</td>
<td>(0.057)</td>
</tr>
<tr>
<td>Born or one in transition year</td>
<td>0.104*</td>
<td>0.094**</td>
</tr>
<tr>
<td></td>
<td>(0.056)</td>
<td>(0.041)</td>
</tr>
</tbody>
</table>

No. of observations: 47,059
Except for those from less-educated households

Effect of transition on life satisfaction, percentage points, by mother’s level of education.

Sources: LiTS III, Correlates of War Data, EBRD transition indicators, Gapminder, UCDP/PRIO Armed Conflict Dataset, and authors’ calculations.
Impact of transition on well-being: summary of results

- Early reforms: time of major socio-economic hardship
  - Especially for less-skilled households
  - Effect is not explained by economic recession alone, also related to deterioration of public goods
- But generation born in transition has benefitted from opportunities due to market reforms
  - Similar income, employment and marital outcomes as other cohorts
  - Higher education and higher subjective well-being
Corruption, support for reforms and confidence in institutions
Corruption, governance and the quality of institutions

- Corruption remains prevalent in the region and continues to dominate reform debates

- Life in Transition Survey shows that “corruption experience” is a more reliable measure of corruption than “perceived incidence of corruption”
  - Possibly due to media bias

- Corruption undermines economic development and trust in institutions
  - Results based on a panel of 1500 locations in LITS 2010 and LITS 2016
Over the past decade, perceived incidence of corruption in the region has declined...

Perceived corruption in 2006, 2010 and 2016 by region

Source: LiTS I (2006), LiTS II (2010), LiTS III (2016).
...but people tend to experience more corruption than is reflected in perceptions, particularly in Eastern Europe

Experience versus perception of corruption in 2016 by country

- **Average experience of corruption**
- **Average perception of corruption**

Source: LiTS III (2016), authors’ calculations.
Democracy tends to go hand in hand with greater transparency and lower corruption.
People in countries with more effective governments are less likely to experience corruption.

Source: LiTS III (2016), World Governance Indicators (2015), authors’ calculations.
Corruption within the law enforcement and justice is correlated with weaker rule of law

Source: LITS III, World Governance Indicators (2015), authors’ calculations.
People in countries with more accountable institutions are less likely to experience corruption.

Source: LiTS III, World Governance Indicators (2015), authors’ calculations.
Low experience of corruption and income growth tend to go hand in hand

Source: LiTS II, LiTS III, IMF WEO, authors’ calculations.
Better educated and those who support democracy and markets are more likely to stand up to corruption

<table>
<thead>
<tr>
<th>Outcome is ➔</th>
<th>Ordinary people cannot do anything</th>
<th>Refuse to pay bribes</th>
<th>Report corruption when you experience it</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>0.127***</td>
<td>-0.040***</td>
<td>-0.069***</td>
</tr>
<tr>
<td></td>
<td>(0.031)</td>
<td>(0.010)</td>
<td>(0.019)</td>
</tr>
<tr>
<td>Male</td>
<td>-0.013***</td>
<td>0.009**</td>
<td>0.020***</td>
</tr>
<tr>
<td></td>
<td>(0.004)</td>
<td>(0.004)</td>
<td>(0.004)</td>
</tr>
<tr>
<td>Married</td>
<td>-0.009**</td>
<td>0.015***</td>
<td>0.001</td>
</tr>
<tr>
<td></td>
<td>(0.004)</td>
<td>(0.004)</td>
<td>(0.004)</td>
</tr>
<tr>
<td>Tertiary education</td>
<td>-0.049***</td>
<td>0.045***</td>
<td>0.031***</td>
</tr>
<tr>
<td></td>
<td>(0.005)</td>
<td>(0.005)</td>
<td>(0.005)</td>
</tr>
<tr>
<td>Support democracy</td>
<td>-0.007</td>
<td>0.046***</td>
<td>0.012***</td>
</tr>
<tr>
<td></td>
<td>(0.005)</td>
<td>(0.005)</td>
<td>(0.004)</td>
</tr>
<tr>
<td>Support market economy</td>
<td>-0.008</td>
<td>0.029***</td>
<td>0.005</td>
</tr>
<tr>
<td></td>
<td>(0.005)</td>
<td>(0.005)</td>
<td>(0.005)</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.05</td>
<td>0.03</td>
<td>0.04</td>
</tr>
<tr>
<td>N</td>
<td>42278</td>
<td>42278</td>
<td>42278</td>
</tr>
</tbody>
</table>
**Trust in government rises where people believe corruption is falling**

<table>
<thead>
<tr>
<th>Outcome is trust in</th>
<th>Trust in president</th>
<th>Trust in government</th>
<th>Trust in parliament</th>
</tr>
</thead>
<tbody>
<tr>
<td>There is less corruption now than 4 years ago</td>
<td>0.178*** (0.016)</td>
<td>0.200*** (0.017)</td>
<td>0.194*** (0.020)</td>
</tr>
<tr>
<td>Unemployment</td>
<td>-0.029* (0.017)</td>
<td>-0.019 (0.013)</td>
<td>-0.012 (0.009)</td>
</tr>
<tr>
<td>Log income</td>
<td>0.025 (0.016)</td>
<td>0.007 (0.012)</td>
<td>-0.005 (0.007)</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.38</td>
<td>0.39</td>
<td>0.40</td>
</tr>
<tr>
<td>N</td>
<td>13544</td>
<td>13779</td>
<td>13636</td>
</tr>
<tr>
<td>Number of PSUs</td>
<td>1489</td>
<td>1489</td>
<td>1489</td>
</tr>
</tbody>
</table>
Experience of corruption makes people less likely to believe government is improving

<table>
<thead>
<tr>
<th>Outcome is</th>
<th>Local government has improved over the last 4 years</th>
<th>Regional government has improved over the last 4 years</th>
<th>National government has improved over the last 4 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corruption experience</td>
<td>-0.065*** (0.018)</td>
<td>-0.071*** (0.015)</td>
<td>-0.040** (0.017)</td>
</tr>
<tr>
<td>Unemployment</td>
<td>-0.035*** (0.010)</td>
<td>-0.016 (0.014)</td>
<td>-0.030*** (0.009)</td>
</tr>
<tr>
<td>Log income</td>
<td>0.006 (0.007)</td>
<td>0.022** (0.008)</td>
<td>0.017** (0.008)</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.29</td>
<td>0.39</td>
<td>0.37</td>
</tr>
<tr>
<td>N</td>
<td>14060</td>
<td>11219</td>
<td>13479</td>
</tr>
<tr>
<td>Number of PSUs</td>
<td>1489</td>
<td>1489</td>
<td>1489</td>
</tr>
</tbody>
</table>
Satisfaction with local government positively affects attitudes toward democracy and market economy

<table>
<thead>
<tr>
<th>Outcome is</th>
<th>Support for democratic regime</th>
<th>Support for authoritarian regime</th>
<th>Support for market economy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Satisfied with local government</td>
<td>0.030*** (0.010)</td>
<td>-0.005 (0.006)</td>
<td>0.034** (0.012)</td>
</tr>
<tr>
<td>Unemployment</td>
<td>-0.022 (0.013)</td>
<td>0.001 (0.008)</td>
<td>-0.037*** (0.011)</td>
</tr>
<tr>
<td>Log income</td>
<td>0.032*** (0.009)</td>
<td>-0.003 (0.005)</td>
<td>0.025*** (0.007)</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.28</td>
<td>0.22</td>
<td>0.26</td>
</tr>
<tr>
<td>N</td>
<td>14487</td>
<td>14487</td>
<td>14487</td>
</tr>
<tr>
<td>Number of PSUs</td>
<td>1489</td>
<td>1489</td>
<td>1489</td>
</tr>
</tbody>
</table>
Fairness and equality of opportunity
Inequality of opportunity

• Opportunity to have education, good job, income should not be limited by circumstances
• In practice, gender, race, place of birth, and/or parental background have an impact
• Inequality of opportunity is inefficient:
  • prevents people from making the best use of their skills or from realising their entrepreneurial ideas
• Inequality of opportunity is unfair:
  • may lead to the loss of confidence in the key economic and political institutions that underpin societies and a market-based economic system
20% to 50% of income inequality in the EBRD region is due to circumstances at birth

- Higher than in western Europe but modest compared with other emerging markets and the US

![Graph showing income inequality and inequality of opportunity for different regions.](image)
Inequality of opportunity and support for the reform

- We decompose inequality into
  - “unfair” inequality of opportunity (explained by gender, race, place of birth, and parental background) and
  - “fair” inequality (residual, explained by effort)
- It turns out that support for market economy is negatively correlated only with the inequality of opportunity
- The “fair” component of inequality is positively correlated with support for markets and economy
- Consistent with Starmans et al. (2017) – people prefer fair inequality to unfair equality
Inequality of opportunity reduces support for markets and democracy – unlike the “fair” component of inequality

<table>
<thead>
<tr>
<th></th>
<th>Support for markets</th>
<th>Support for democracy</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td><strong>Direct channels</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inequality of opportunity: income</td>
<td>-4.508*</td>
<td>-4.169*</td>
</tr>
<tr>
<td></td>
<td>(2.112)</td>
<td>(2.085)</td>
</tr>
<tr>
<td><strong>Indirect channel</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Perception of relative economic wellbeing</td>
<td>0.077***</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0.022)</td>
<td></td>
</tr>
<tr>
<td><strong>Controls</strong></td>
<td></td>
<td></td>
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<tr>
<td>Income decile</td>
<td>0.042***</td>
<td>0.035**</td>
</tr>
<tr>
<td></td>
<td>(0.011)</td>
<td>(0.011)</td>
</tr>
<tr>
<td>“Fair” income inequality</td>
<td>4.424**</td>
<td>4.516**</td>
</tr>
<tr>
<td></td>
<td>(1.587)</td>
<td>(1.600)</td>
</tr>
<tr>
<td>Level of democracy (polity2)</td>
<td>0.058**</td>
<td>0.061**</td>
</tr>
<tr>
<td></td>
<td>(0.020)</td>
<td>(0.019)</td>
</tr>
<tr>
<td>Additional individual, region and country controls</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Observations</td>
<td>12,258</td>
<td>12,185</td>
</tr>
</tbody>
</table>

Sources: LiTS III, IMF, authors’ calculations. Also controlling for unemployment, GDP growth, inequality of opportunity with respect to jobs and education, other characteristics.
Emergence of oligarchs
Perceptions of change in income inequality: very different from the household survey data

Changes in inequality: measured and perceived

Sources: World Bank Povcalnet, Solt (2014), LiTS III and authors’ calculations.
Why perceptions of inequality differ from the household survey data?

- Household data do not capture the very poor and the very rich
- In post-communist countries, there is a disproportional presence of the super-rich
  - Their wealth is mostly coming from natural resource rents
  - In other countries, the resources rents are taxed away by the state
Concentration of wealth at the top is high by international standards

Regional share of global billionaire wealth in % of regional share of global GDP

Sources: Forbes, IMF WEO and authors’ calculations.
And driven mostly by commodity rents, rather than innovation or competitive manufacturing.
Guriev and Rachinsky (2005)

• In Russia 2002, 22 business groups control about 40% sales and employment
  • Mostly present in natural resources industries
• Outperform state-owned enterprises and other private firms
• At par with foreign-owned firms
Crony capitalism and informational autocracy

Guriev and Treisman (2016)

• Modern autocrats use money and information rather than ideology/repression
  • Remain “popular” rather than feared
    – Convince the public that the leader is “competent”
  • Treat differently the informed elites (who can judge the quality of the leader) and the uninformed masses
    – Use propaganda for masses
    – Bribe or censor elites
    – Those who choose to be bribed become the regime’s cronies
Informational autocracies: empirical analysis

- Gallup World Poll data, 100+ countries, 2006-2016, one million observations
- Analyze approval of national government and perception of media freedom
  - By definition, censorship censors information on the presence of censorship
  - Use tertiary education as a proxy for “elite” (understanding the quality of the leader)

Results
- In democracies, educated are more likely to approve the government
  - As they are better-off today and have brighter future
- In non-democracies, educated are less likely to approve the government
  - Despite being better-off
- Media freedom: self-reported perceptions vs. “objective” Freedom House score
  - Censorship only works for the non-educated – they are convinced there is no censorship
  - For educated, there is no gap between perceived and objective scores