Essays in empirical macroeconomics on democracy, income inequality and financial liberalization

Chapter 6

Valorization Addendum

This thesis not only contributes to academic understanding of the research topics, but also provides broader implications to society. The European Union (EU) explicitly makes international cooperation conditional on the maintenance of democracy.[1] Furthermore, the EU devotes substantial amount of resources to promoting democracy worldwide.[2] A better understanding of the emergence and consequences of democracy is thus of considerable interest to EU policy. Additionally, one of the core purposes of the EU is to foster stronger economic ties between its member states, with the goal to improve standards of living across Europe. One such tie between countries is the extent to which they are financially open to one another. A better understanding of whether financial openness indeed improves economic outcomes thus helps determine whether the trajectory followed by the EU has been effective, or whether it requires any adjustments.

This section briefly summarizes the main implications from each chapter for academic researchers, policy makers or society:

Democracies are fragile to economic and financial crises, and highly democratic countries tend to become less democratic during such crises. Democracy goes hand in hand with the provision and enforcement of human rights, hence a (partial) democratic collapse may weaken such human rights. Economic and financial crises are economically very costly in themselves, but a reduction in rights adds additional societal damage on top of it. In contrast, non-democracies tend to democratize partly during times of crisis. For academic researchers, Chapter 2 provides new insights into which factors drive regime changes. Prior research around democratization largely operated under the assumption that crises are relevant. Chapter 2 provides evidence that this is indeed the case. Furthermore, by distinguishing between different crisis types, it paves the way for further research, by establishing which crisis periods are most worthwhile studying in greater depth. For the EU, there are several implications. First, crises such as the recent Global Financial Crisis may pose a threat to democracy across the EU. A rapid, EU-wide resolution of such crises may be

[1] The Cotonou Agreement is an example hereof.

[2] The European Instrument for Democracy and Human Rights is a prime example of the EU's focus on democracy.

necessary not only to contain any economic damage, but to also prevent democratic decay within the union. Anti-EU sentiment across countries such as Hungary, Poland and the UK (culimating in Brexit) are likely in part driven by this late crisis. At the time of writing, the economic crisis induced by the COVID pandemic requires an EU-wide rapid, strong resolution so as to prevent additional undermining of democracy. As highlighted at the start of this section, the EU also has explicit policies promoting democracy around the world. Based on the results in this thesis, policy makers need to pay particular attention to countries undergoing economic crises. Among highly democratic countries, crises undermine EU efforts to promote democracy. Democracies may thus need more active EU participation to prevent democratic decay. Among weak democracies, economic crises may instead provide an opportunity for the EU to push for further democratization.

The results in Chapter 3 show that income inequality is unaffected by changes in the level of democracy. There is no evidence that democratization results in any income redistribution nor does it have any impact on income inequality. Democratic breakdowns are similarly not associated with any developments in income redistribution or income inequality. Changes in the level of democracy are thus not of paramount importance to the distribution of income or the distribution of standards of living. For academic researchers, it provides further evidence that existing models connecting democracy to income inequality make inaccurate predictions. The Sustainable Development Goals (SDGs) posed by the United Nations promote sharing prosperity in an equitable and sustainable way, so as to reduce poverty. The results in Chapter 3 highlight that this goal is unlikely to be reached by promoting the institution of democracy, but that it is better accomplished using different means instead. Policy makers attempting to implement and reach the SDGs related to inequality should thus not prioritise the process of democratization.

Capital account liberalization on average results in higher economic growth. The effect on growth is modest and it is quite short-lived, but nevertheless results in higher permanent GDP per capita. Capital account liberalization is known to expose countries to a higher risk of economic and financial crises. The effect on GDP per capita may thus be short-lived too, if a crisis ensues not long after liberalization. Policy makers have, in the past, pursued capital account liberalization as a way to achieve higher economic growth. The results in Chapter 4 show that such growth is quite limited, and that it is not a panacea guaranteeing more and more prosperity via ever-increasing GDP. Policy makers should thus consider capital account liberalization carefully and not pursue it as a blanket policy, as the costs caused by crises may outweigh the benefits generated via temporarily higher growth. For academic researchers, Chapter 4 provides new evidence on the magnitude and persistence of the effects of capital account liberalization. By explicitly accounting for potential feedback processes and including potential transmission mechanisms between capital account liberalization and economic growth, the results provide a more detailed understanding of the impact of liberalization policies than prior studies.