9

REGIME TRANSITIONS AND REDISTRIBUTION: PROSPECTS FOR A STABLE DEMOCRACY IN EGYPT AND LIBYA

Francesco Alfonso

ABSTRACT

The paper presents a model of regime transition in which inequality and the mobility of capital are the key analytical dimensions as they influence the likelihood of survival of democratic settings once they have been established. These concepts are applied to Egypt and Libya, currently experiencing political turmoil. Other things being equal, if democratic institutions were to appear following popular revolts in Libya and Egypt, the idiosyncratic characteristics of these two economies make their survival more difficult for the former than the latter. Although both countries have experienced decades-long autocracies, Egypt has managed to diversify its productive activities in a way that has created mobile capital in sectors such as services and manufactory. On the other hand, Libya still relies almost completely on its natural resources, a highly fixed kind of capital. Given levels of equality resulting from redistributive policies under more representative institutions, the differences in the kind of capital endowments will make it a harder journey for the consolidation of democratic settings in Libya than in Egypt.

Francesco Alfonso is a 2012 graduate of the M.P.A. in Public and Economic Policy at the London School of Economics' Institute of Public Affairs, where he specialised in Economic Policy Analysis. Contact: F.Alfonso@lse.ac.uk, Francesco.alfonso@gmail.com.

I. INTRODUCING THE MODEL

In the model presented in this paper, the population varies along two dimensions: the level of capital endowments of each individual and the extent to which the capital is mobile[87]. Two types of individuals, poor and rich, are considered. The former group, which represents a larger share $\alpha > \frac{1}{2}$ of the population, holds together a capital stock k_p, while the latter, a small share 1- α in the society, controls the remaining stock of capital k_r. Thus, each individual $j = \{p, r\}$ is endowed with a level of capital k_j^i so that, by definition, $k_p^i < k_r^i$ and income, that generates from capital, is $y_p^i < y_r^i$. As the share of capital owned by the rich increases, *inequality* increases.

The second relevant dimension is the *mobility of capital*, that is, the extent to which assets lose productivity if they are moved to another country. More formally, if capital k at home results in a level of income $y^h = k$, when moved abroad it loses a share of its productivity and therefore translates in a lower level of income $y^a = (1 - \delta)k$. Thus, the more country-specific the capital, the larger δ and therefore the less convenient it is for capital owners to move their assets abroad.[88]

In a democracy[89], the state taxes all individuals with a linear tax t on their income and then redistributes equally among them (Meltzer and Richards 1981). Hence, the income of each individual is a function of his initial level of capital plus the net transfers T^i that he receives from the state: $(1 - t)k^i + T^i$. Because of the mechanism of electoral competition, the selected tax rate is the one preferred by the median voter, and because the median voter is poor, a positive net transfer for the poor and a negative one for the rich is expected (that is, progressive redistribution of income).

On the other hand, in an authoritarian regime there are no redistributive taxes. That is, the rich group maintains its income but devotes a portion ρ of it to those activities that are necessary to secure the nondemocratic environment, such as the repression of revolts arising from disenfranchised people or the

[87] This paper will rely on contributions presented in Boix (2003), but for the sake of simplicity the following aspects are excluded: i) deadweight losses from taxation, ii) political mobilization that increases the costs of repression and iii) wealth loss during revolutions.

[88] Land and natural resources are considered immobile assets because they cannot be transferred abroad. More precisely, although the output that generates from those assets is tradable, the sources of income themselves are fixed and geographically bound. In practice, what is fixed is the right to exploit those resources. At the other end of the spectrum, money and human capital are examples of highly mobile assets because they can easily move abroad insofar as there are low barriers to capital flows and migration, respectively.

[89] Intended here as an institutional framework in which citizens are not excluded from the electoral franchise on the basis of their gender, race, political preferences or economic status.

arbitrary allocation of privileges to key actors in the society to keep a minimal winning coalition[90]. Thus, in authoritarian settings the income of the rich is $k_r^i - \rho_i$ while the income of the poor is simply k_p^i .

Given this framework, the selection of political regimes –the transition from democracies to autocracies and vice versa– can be seen as the outcome of the game played by rich and poor groups trying to maximise their level of income and facing opposite incentives. For the purposes of this paper, instead of looking at all the possible equilibria of the game, I will focus on the conditions for the survival of a stable democratic regime, once established. In doing so, I welcome the view of Przeworski and Limogi[91] –who allow democracy to take place exogenously– and use the arguments aforementioned (Boix 2003) to give an endogenous explanation of its persistence.

II. CONDITIONS FOR A STABLE DEMOCRACY

Two implications arise from the model, which will be useful to think about the determinants of a stable democracy:

i) As inequality in the society increases, democracy becomes less stable. Other things being equal, if the income of the rich grows relatively to that of the poor, there will be a higher demand for redistribution through taxation. Facing this pressure, the rich might think that an authoritarian regime could be a better option for their wealth and decide to establish a dictatorship. Thus, on this dimension, the choice of the rich elite whether to mount a coup is determined by a comparison of the increased cost of democracy (T) and the costs that they will have to bear to maintain the nondemocratic setting (ρ). On the other hand, when the gap between the rich and the poor is narrow, the median voter is endowed with a relatively high share of capital. It follows that the costs for the rich arising from redistribution are low compared to the costs of repression and therefore we expect democracy to be more stable.

[90] Bueno de Mesquita *et al* (2003).

[91] Questioning *modernization* theories, which claim a causal link between economic development and democracy, the authors argue that democratic regimes appear randomly with respect to development. Indeed, dictatorships may fall for reasons other than economic growth: death of the ruler, wars, foreign pressure. The reason why there is correlation between democracies and rich countries is because the former are more likely to survive in developed countries than in poor ones. Hence, democracy persists "if a country is *modern*, but it is not a product of *modernization*" (1997:158-159).

ii) The other relevant dimension for this analysis is the mobility of capital. When capital is highly country-specific, in fact, it is more expensive for asset holders to move it abroad and lose productivity (δ) than keeping it at home and make it taxable. As capital becomes more mobile, it can be easily transferred without significant loss in terms of productivity. According to this logic, capital holders will keep their assets at home only up to a certain level of taxes, because if these are too high, they will move their capital somewhere else. It follows that, in a democracy, the median voter will be constrained in the choice of the tax rate by the mobility of capital: as it increases, taxes will decrease under the threat of the rich to move their assets away.

How does this affect the stability of a democracy? Other things being equal, at low levels of capital mobility taxes will be high, so will be the cost of redistribution, thus making the possibility of an authoritarian change more likely. Conversely, as capital in the economy becomes more mobile, the chosen level of taxes will decrease, thus reducing the incentive for an authoritarian shift and ultimately making democracies more stable.

In the light of these considerations, additional comments can be made:

First, the correlation observed between democracies and developed countries finds here an alternative explanation to modernization theories. Instead of being *caused* by economic achievements, democratic settings are more likely to survive in modern economies because they are characterized by relatively more mobile capital assets. Indeed, as Boix (2003:41) points out, “the process of economic development is the story of a shift from highly immobile fixed assets to progressively more mobile capital, that is, from societies that rely on the exploitation of land and mines to economies based on manufacturing industries and human capital-intensive business”. Therefore, even if democratic solutions may appear randomly with respect to development, they consolidate more easily where the capital is less country-specific, whereas they experience more serious authoritarian threats in those economies that are based on highly immobile fixed assets. Thus, over time they accumulate in the former and disappear in the latter.

Similarly, this framework provides insightful tools to understand the existence of wealthy authoritarian regimes. As mentioned earlier, rich countries are correlated with democratic institutions to the extent to which their capital is relatively mobile, meaning that their economies are mainly based on manufactories and services rather than agriculture or extractive activities. Conversely, if an economy draws the most significant part of its income from a highly fixed kind of capital –unless the resources are equally distributed among the population– the owners of those assets will be reluctant to accept democratic concessions for fear of redistributive expropriations. This is often the case when one looks at countries rich in natural resources, such as middle-eastern fossil fuel-based autocracies. Consistently with what observed by Ross (2001), dictatorships that base their revenues on oil exports will dispose of large budgets, which they can use to curb the democratic aspirations of their people ("rentier effect") or block them with increased spending in internal security ("repression effect").

For the purpose of this paper, it is worth highlighting two other mechanisms that help explaining the persistence of nondemocratic regimes in countries rich in natural resources. First, what the literature refers to as the "Dutch disease" inhibits the growth of agricultural and manufacturing sectors through, on the one hand, an appreciation of the exchange rate due to a boom in natural resources exports and, on the other hand, by drawing capital and labour away from those same alternative sectors, thus raising their production costs. Second, because such authoritarian regimes enjoy large revenues from extracting their natural resources, they have limited incentives to stimulate and diversify the domestic economy to foster alternative sources of income on which they can levy taxes (Ross 1999:306). As a consequence, investments in private enterprises and education will hardly be rewarded, secondary and tertiary sectors will struggle to flourish and the accumulation of capital of a more mobile kind will ultimately be hindered, thus making the transition to and the survival of a consolidated democracy less likely.

With this in mind, the prospects for stable democracies in Egypt and Libya are explored in the next section.

III. PROSPECTS FOR STABLE DEMOCRACIES IN EGYPT AND LIBYA

In the first months of 2011, several authoritarian regimes in the Middle East have been put under threat by popular demonstrations asking for democratic reforms. While some of the rulers agreed to step down, others are still engaging in repressing domestic revolts at the time of the writing of this paper. In the cases of Egypt and Libya: what can be said about the chances for the survival of more representative institutions in the light of the first two sections of this paper?

Egypt – After Hosni Mubarak stepped down as President on 11th February 2011, the Supreme Council of the Egyptian Armed Forces has taken control of the country with an official commitment to implement constitutional amendments and conduct free and fair presidential elections[92]. Exacerbated by soaring food prices, an improvement of economic conditions was certainly among the reasons that prompted the popular revolt calling for greater equality and better living standards. Also, according to various

[92] New York Times (2011)

estimates[93], despite the economic reforms and privatizations occurred in the last decade, the military might control up to 40% of the Egyptian economy. Clearly, such a powerful actor in the society faces considerable incentives to maintain the control of the nation and limit the level of redistribution: the replacement of Mubarak with another authoritarian figure is indeed a possibility for the future of Egypt.

At the same time, the nation's economy is rather developed, with the presence of a diversified industrial base that ranges from the well-established production of automobiles, textiles and electronics to more advanced sectors such as chemicals, telecommunications and optical equipment. Indeed, according to official figures[94], fixed assets such as oil and gas extractive activities, as well as agriculture, both account for nearly 15% of the GDP, while manufacturing industries, tourism and services are responsible for the remaining 70%.

In the context of the framework exposed in this paper, this means that Egypt is characterized by relatively mobile capital assets. Therefore, if democratic reforms were to take place in the country and reduce inequality, its diversified and modern productive system might help curbing the redistributive pressure on capital holders, thus limiting their incentives to return to an authoritarian regime and putting a new Egyptian democracy on the path of consolidation.

Libya – Following nationwide protests erupted against Mu'ammar Gaddafi, the Interim Transitional National Council was established on 5th March 2011 with the goal of putting an end to the long-lasting dictatorship and hold free parliamentary elections[95]. A civil war between regime forces and voluntary rebels is currently underway, the outcome of which seems likely to depend on the effectiveness of the military intervention of international powers in support of the rebel groups. If one accepts the possibility of a democratic change in Libyan institutions, how will the country's economy influence the likelihood of their survival?

With regards to inequality, the Socialist experiment enacted at the end of the 1970's had the explicit goal of building an egalitarian society. Class differences were reduced by measures such as the abolishment of rental payments for housing and the elimination of the relationship between employer and employee, which *de facto* banned the individual private ownership of businesses. At the same time, state-managed oil revenues have made it possible to support an extensive range of measures that lifted living standards for the average Libyan citizen, such as free education and health as well as subsidies to food and utilities.

[93] NPR (2011a)
[94] Ministry of Planning (2011)
[95] Interim Transitional National Council (2011)

With respect to the region and to other oil-producing countries, Libya has a higher per capita GDP and performs better with regards to indicators of health, education, and gender equality.[96]

The removal of virtually all kinds of property rights and the control of the banking system stifled the private sector with effects that lasted even after subsequent market-oriented reforms adopted in the 1990's. As a result, the private economy is currently limited to 2% of the GDP by controls on price, credit and trade, with the ultimate effect of hindering the development of non-oil sectors, the diversification of the economy and the consequent creation of more mobile kind of capital. Indeed, the economy of Libya is still centrally controlled and depends heavily on its natural resources, which contribute 95% of exports revenues[97] and more than 80% of industrial activities[98]. At the same time, the desert limits agricultural land to the extent that the country has to import about 75% of the food that is consumed within its borders.[99]

With such a country-specific capital base –and despite the state ownership of crucial economic assets that made it possible to reduce inequality and secure Libyans with improved living conditions– the odds for the survival of a democratic setting may be weakened by the incentives faced by newly formed elites seeking to extract rents and power from the country's natural resources. On the other hand, consistently with what has been presented in this paper and what is suggested by Acemoglu and Robinson (2001:957), redistribution through assets should be the policy recommendation to be drawn for the next Libyan ruling class. Arguably, the chances for the consolidation of a democratic Libya could be strengthened if future governments will strategically redistribute hydrocarbon financial resources to foster non-oil growth and productivity. For instance, by providing infrastructure and investing in the quality of human capital to develop a more skilled labour force, a diversified economy could arise that will help a young democracy escape the threat of a new authoritarian regime and consolidate over time.

IV. CONCLUSION

In this paper I presented a model of regime transition in which inequality and the mobility of capital are the relevant analytical dimensions. In particular, the specific conditions that influence the likelihood of survival of democratic settings once they have been established are explored. These concepts are then applied to two countries that might experience a democratic shift in the near future.

[96] World Bank (2006:2-6)
[97] CIA (2011)
[98] NPR (2011b)
[99] CIA (2011)

Other things being equal, if democratic institutions were to appear following popular revolts in Libya and Egypt, the idiosyncratic characteristics of these two economies make their survival more difficult for the former than the latter. Although both countries have experienced decades-long autocracies, Egypt has managed to diversify its productive activities in a way that has created mobile capital in sectors such as services and manufactory. On the other hand, Libya still relies almost completely on its natural resources, a highly fixed kind of capital. Given the levels of equality that would result from redistributive policies under more representative institutions, differences in the kind of capital endowments will make it a harder journey for the consolidation of democratic settings in Libya than in Egypt.

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