

Inequality and Politics

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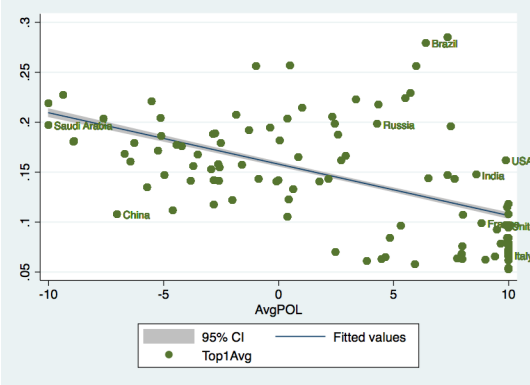
Inequality and Politics

Today I will discuss the relation between inequality and politics (political institutions) focusing on:

- How political institutions affect economic inequality (PART 1)
- To what extent economic inequality may affect the health of political institutions (PART 2)
- Historical case studies

Democracy and Inequality

Democratization and Top 1percent Income Share



Democracy and Inequality

Observations and questions:

- 1 Negative correlation between the strength of democratization and a measure of inequality
 - ▶ What is the impact of democratic governments on inequality?

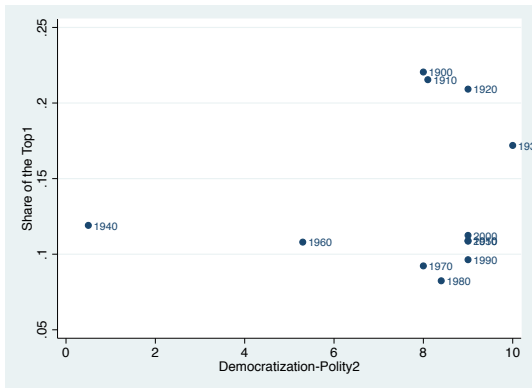
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- 1 Negative correlation between the strength of democratization and a measure of inequality
 - ▶ What is the impact of democratic governments on inequality?
- 2 Variation in the level of inequality even among countries having 'full democracies'
 - ▶ What is the effect of inequality on the health (sustainability) of broad based political institutions?

Democracy and Inequality

Top 1percent Income Share: France



Democracy and Inequality

While inequality negatively correlates with the level of democratization, high income concentration and democracy can cohabit for long periods.

- Why is this the case?
- Conventional wisdom is coherent with the correlation:
 - ▶ Electoral incentives should support redistributive policies
- However there are other good reasons why electoral incentives may not work as suggested by intuition

Why are democracies less equal than what we expect?

Cleavages

- Societies may be divided over cleavages that go beyond economic inequality (religion, identity, migration). When cleavages other than income or wealth inequality are more salient, equalizing policies may be inhibited (because the electoral incentives and selection are driven by other dimensions. (Lipset and Rokkan, 1967; Romer, 1998))

Why are democracies less equal than what we expect?

Fairness

- The work of Piketty (1995 and 2019) or Alesina and Angeletos (2005) and Benabou and Tirole (2006) have shown that a preference for fairness could lead two identical societies to choose different economic systems:
 - ▶ Two possible equilibria:
 - ▶ one where a belief that the income-generating process is 'fair' because effort is important prevails implying low taxes and redistribution (an 'American' equilibrium)
 - ▶ another where the belief that the process is 'unfair' because luck prevails in which we'll have high taxes and redistribution

Why are democracies less equal than what we expect?

Capture: Democracy and equality might not go hand in hand if democracy is captured by the wealthy.

- How does capture happen?
 - 1 Acemoglu and Robinson (2018) suggest that members of the elite have incentives to invest part of their resources in sources of de facto power (lobbying, appointment).

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- 3 These two elements implicitly answer to our second question: democracy may be ineffective in reducing inequality and wealth concentration may be favor capture

=> **Medici vicious circle**, Zingales (2017)

Wealth and Capture of Political Institutions

Despite many have pointed out the risks of capture, we still have little evidence about:

- The mechanisms and circumstances under which institutional capture can happen.
- The consequences of the capture on political officers' wealth accumulation.

=> two historical case studies: Venice and Florence

Wealth and Capture of Political Institutions: The Case of Venice

Puga and Trefler (2014) examine the history of Venice (800-1600) under the lens of the income and wealth shocks implied by international trade. They describe two main moments in Venice's history:

The Rise: social mobility and constraints on the government (10th-13th).

- In the 10th century the growth of long-distance trade enriched a broad group of merchants who used their newfound economic power to push for constraints on the government
- The merchants also pushed for remarkably modern innovations in contracting institutions that facilitated longdistance trade: the *colleganza* that allowed many families to join international trade and become rich

Wealth and Capture of Political Institutions: The Case of Venice

The Fall: political capture and barriers to entry.

- Starting in 1297, a small group of particularly wealthy merchants blocked political and economic competition: they made parliamentary participation hereditary and erected barriers to participation in the most lucrative aspects of long-distance trade
- Over the next two centuries this led to a fundamental societal shift away from political openness, economic competition, and social mobility and toward political closure, extreme inequality, and social stratification.

Wealth and Capture of Political Institutions: The Case of Venice

How do they explain these dynamics?

- The initial trade shock stimulates the demand of constitutional reforms (to protect high stakes)
- However, in the following centuries, rich established merchants see that competitors may erode their rents
- they make a coalition with emerging new merchant; allow them into the city government and close the trade to other families (barrier to entry) to secure future rents

The Rise of the Medici and the Fall of the Florentine Republic

In Belloc, Drago, Fochesato and Galbiati (2020), we revisit the experience of the Florentine Republic in the 14th and 15th centuries

- During the 15th century, the Medici family increased its influence, captured the system of office allocation and de facto ruled the city, leaving the political institutions formally unchanged
- Before the capture, Florence was a republic with a (relative) large franchise: political offices assigned by a mix of elections and lottery.

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 - ▶ Ideal setting to describe a mechanism of (soft) capture.
- Before the capture, Florence was a republic with a (relative) large franchise: political offices assigned by a mix of elections and lottery.
 - ▶ By comparing the "pre" and the "post-capture" period we understand how access to political offices affects individual wealth in a captured vs. a representative system.

Historical background

- In the 12th c., Florence established itself as an autonomous Republic (Commune), with effective political control over the nearby countryside.
- Throughout the following two centuries the city consolidated its republican institutions, which guaranteed political participation to the economic and social leading groups of the city.
- At the same time, the Republic of Florence emerged as one of the leading economic urban centres of Europe, with its economic success revolving around textile and banking activities.
- During the 15th c. the city reached the peak of its economic, political, and cultural development.

Political institutions

Executive political power (*Tre Maggiori*):

- *Signoria*, formed by *Gonfaloniere di Giustizia* (Standard-bearer of Justice) and 8 *Priori* (Priors) → highest political executive power.
- 12 *Buonumini* (Good Men) → supportive advisory role.
- 16 *Gonfalonieri di Compagnia* (Standard-bearers of the Companies) → supportive advisory role.

Legislative power (but not initiative):

- Council of the *Popolo* (300 citizens).
- Council of the Commune (200 citizens).

Political institutions and *Tratte* system



- Since 1345, the members of the *Tre Maggiori* were appointed through a process of random selection among a group of eligible citizens, the so-called system of *Tratte*.
- The length of the officials tenure varied from 2 to 4 months depending on the office. This guaranteed that sooner or later all eligible citizens were elected for an office.

Political institutions and *Tratte* system

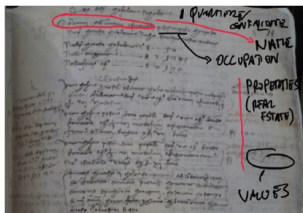
- These institutions, by combining a system of **stratified representation, selection by lot, and short term limits** guaranteed a substantial alternation of power for about 100 years (Brucker, 1977; Guidi, 1981; Najemy, 1982; Padgett, 2000).

Data

We rely on data from primary and secondary sources on:

- Individual data on the results of the office holders selection over the period (1393-1457).
- The party affiliation of the individuals (1426).
- Individual wealth in different points in time (1403, 1427, 1457).
- Individual public debt contracts (1427, 1434, 1440, 1455).

Data: Catasto of 1457/58



- The document, available at Archivio di Stato in Florence and studied qualitatively by Molho (1994), had not been digitized before.
- We have drawn on the information reported in the original copies of the 48 volumes and edited a digital version of the 1457/58 wealth records.
- The final document contains records on 7,455 households.

Empirical analysis - Wealth and Access to Politics before the Rise of the Medici

- Empirical question: is there a private return to holding an office before the rise of the Medici?
- Since a term in office is conditional on being drawn and since draws are random (*tratte*), we exploit draws to instrument terms in office.
- We provide evidence consistent with the historical narrative that draws were random until the 1420s:
 - ▶ The ranking of wealth in 1403 does not predict the number of individual draws later on.
 - ▶ Draws are at each year are independent from previous draws.
 - ▶ The relationship between draws and access to office is not dependent on individual fixed effects.

Results on total assets in 1427: before the Medici

Reduced form				
Dependent variable: Total assets in 1427				
Draws in the period 1393-1427	0.0412*** (0.0113)	0.0156 (0.0164)	0.0111 (0.0156)	0.0031 (0.0155)
R-squared	0.0671	0.0965	0.1018	0.1295
Observations	396	396	396	396
Neighborhood FE	YES	YES	YES	YES
Number of purses FE	NO	YES	YES	YES
Office FE	NO	NO	YES	YES
Corporation FE	NO	NO	NO	YES

IV				
First stage - Terms in the period 1393-1427				
Draws in the period 1393-1427	0.4967*** (0.0498)	0.0770** (0.0332)	0.0714** (0.0315)	0.0697** (0.0314)
R-squared	0.6195	0.8229	0.8254	0.8260

Second stage - Total assets in 1427				
Terms in the period 1393-1427	0.0830*** (0.0232)	0.2033 (0.2401)	0.1557 (0.2397)	0.0444 (0.2198)
Observations	396	396	396	396
Neighborhood FE	YES	YES	YES	YES
Number of purses FE	NO	YES	YES	YES
Office FE	NO	NO	YES	YES
Corporation FE	NO	NO	NO	YES

Rise of the Medici: Giovanni



- The house of the Medici rapidly emerged following the rise of its banking company started in 1397.
- After Giovanni, the leadership was taken by of his son, Cosimo, who expanded the banking activities throughout all Europe and diversified the company business in other sectors.

Rise of the Medici: Cosimo

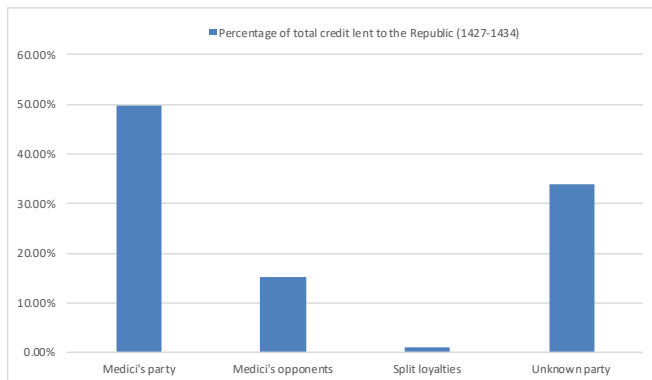


- When, during the 1420s, Florence was involved in the Lombard Wars, the military expenses increased sharply inducing a harsh fiscal crisis.

Two consequences:

- The Republic ordered registration of detailed information on individual wealth (*Catasti*) to determine fiscal contributions.
 - The Republic sought to finance expenditures with voluntary loans.
- Cosimo provided a large share of them, using the enormous personal liquidity that he accumulated as a banker.
 - The Medici became the main creditors of the Republic.

Rise of the Medici: Cosimo



Rise of the Medici: Cosimo



Ask your soldiers how many times they were paid with my own funds, the Commune subsequently repaying me when it was able to do so.
Cosimo, 1424, *Magni Cosmi Medicea Vitae*, 1789

- Hence, the political and economic influence of the Medici increases during the 1420s and consolidates after 1434.
 - ▶ In 1434, when the system had not yet been totally captured, the Albizzi made it to push the Florentine government to exile Cosimo for a few months. After this episode, Cosimo strikes back and takes the full political control of the city.

The Medici: consolidation of power



- The Medici did not formally alter the institutional setting, but implemented their systematic manipulation.
- Cosimo built strong economic and social networks establishing ties with other families against the existing elites (Kent, 1978).
- Credit and marriage networks were the main drivers of the Medici political ascendancy (Padgett and Ansell, 1993).
- Cosimo never held lasting political offices.

The Medici: manipulation of the system



- Manipulation of the lists of citizens to be voted for the scrutinies.
- Manipulation of the drawings.
- Manipulation of tax audits.

Results on total assets in 1457: Medici vs other families

	OLS - Total assets in 1457			
	After 1427		After 1434	
	<i>Other families</i>	<i>Medici's faction</i>	<i>Other families</i>	<i>Medici's faction</i>
Terms between 27(34) and 57	0.1176*** (0.0322)	0.1741* (0.1013)	0.1208*** (0.0494)	0.2430*** (0.0982)
R-squared	0.1479	0.1544	0.1595	0.4223
Observations	473	104	422	100
Neighborhood YES	YES	YES	YES	YES
Number of bags YES	YES	YES	YES	YES
Office FE	YES	YES	YES	YES
Corporation	YES	YES	YES	YES

Summary and Other findings

- 1 We document the mechanisms of the capture and its consequences in terms of wealth accumulation of political officers.
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 - ▶ Collusion and rent extraction as the main driver of the positive return to office.
- 4 By collecting data on income sources in the 19th century & comparing the two periods, we show that political participation after the Medici's capture predicts rents in the long run
 - ▶ Capture changed the structure of the stratification of the society

Venice and Florence

What do these two stories have in common?

- They both had apparently solid institutions granting participation (and in the case of Florence breaking the link between wealth and access to political offices)
- In both cases, factors independent from politics (trade and banking) favoured wealth accumulation for a few families
- Different critical junctures make of this high wealth concentration a determinant of institutional capture

Concluding Remarks

- Inequality can persist even in democratic regimes:
 - ▶ Despite the demand for redistribution, electoral incentives may not necessarily determine that inequality reducing policies will be implemented when other dimensions (cleavages, fairness) also matter for voters
 - ▶ The elites have incentives to capture politicians
- Despite democracies can survive to high inequality, in critical moments (not easy to predict) inequality can favor the capture of political institutions and threaten their sustainability