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Inequality and Institutions

Exploring the Mediating Role of Political Settlements in Some Selected African Countries

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Abstract

In this paper, we quantitatively examine the interplay of legal, political and economic institutions, and political settlements on income inequality. We focus on the marginal effect of the institutional variables on income inequality conditioned on political settlements. The findings show that the marginal effect of legal, political and economic institutions contingent on competitive clientelist political settlements exacerbates income inequality significantly. This means that the politics and power play in competitive clientelist political settlements are detrimental to equality and poverty reduction. Therefore the dynamics of inequality depend primarily on how the elites respond to the emerging balance of power. These findings present a gloomy picture about the impetus for structural transformation and poverty reduction in sub-Saharan African countries since the underlying distribution of power in the emerging forms of democracy in the region are becoming competitive clientelist. The difficult policy challenge is how to use appropriate governance strategies to develop effective institutional structures that can harness elite power for the sake of the national interest.

Keywords

Inequality; Institutions; Political settlements; sub-Saharan Africa

Bio

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Introduction

Inequality represents a growing challenge with multiple implications for the realization of economic and social potentials and the achievement of internationally agreed goals including the Sustainable Development Goals (SDGs). Inequality is a bane to the poverty reduction agenda in many developing countries. Evidence suggests that Africa is the second most inequitable region after Latin America (AfDB 2013). More than one-third of countries in sub-Saharan Africa (SSA), several of them fragile and conflict-affected states, had poverty rates of more than 50 percent in 2010. Recent evidence shows that inequality seems to be on the increase in many SSA countries despite the general moderate decline in absolute poverty. For instance, in Ghana the latest wave of the Ghana Living Standards Survey shows that the Gini coefficient has increased from 0.423 in 2012 to 0.43 in 2017. The average Gini coefficient for SSA is 0.43 (UNDP 2017). Many research works have suggested that inequality in developing countries is facilitated by the way political, economic and legal institutions have been created and maintained by ruling elites.

Institutions are widely defined as formal and informal rules of the game, and their enforcement characteristics (North 1990, 1993, 2005). North (1993) likewise distinguishes institutions from organizations, which are the players of the game, be it individuals, firms, organizations or any other definable social construct. The game, in this regard, is any social interaction. The role of institutions is generally considered as a major determinant of growth and development outcomes. For instance, it has been shown that distinctions in institutional quality are fundamental for understanding variations in development performances such as poverty and inequality among others (North et al. 2009; Bukenya and Yanguas 2013). Stiglitz (2018) indicated that what separates developing countries from the developed is not disparity in resource, but a disparity in knowledge and quality of institutions.

Recently, most studies, exemplified by Acemoglu and Robinson (2008, 2012) and North et al. (2009), seek to determine the political basis for growth and development enhancing institutions. North et al. (2009) and Acemoglu and Robinson (2012) have indicated the importance of politics and power relations in shaping long run processes of development. A key characteristic of their framework is the emphasis on the underlying power arrangements that underpin the stability and performance of institutions. They opine that if the underlying power dynamics between political elites are different, then similar institutions would produce divergent development outcomes (see Abdulai 2017). The World Bank too, in the 2017 World Development Report on 'Governance and the Law', embraced this notion that politics matter and that the balance of power in society may condition the kinds of results that emerge from commitment, coordination, and cooperation of institutions of the state. This understanding about institutions is most powerfully demonstrated by the concept of political settlements developed by di John and Putzel (2009) and Khan (2010, 2018)[1]. Khan (2018) argues that the way institutions work in practice is contingent on the responses of the organizations functioning under these institutions. The relative power and capabilities of organizations are therefore significant determinants of how institutions work. The distribution of organizational power is defined as the political settlement. Political settlements therefore constitute a common

[1] Khan developed the political settlements approach as a way to generally understand the patterns and evolution of the distribution of power in particular societies; in other words, sets of institutions and power relations are seen as constellations that characterize the social order in a particular country in the global economy.

understanding or agreement, usually among elites, on how power and resources are to be distributed and how state-society relations are to be articulated.[2] In other words, the type and nature of the political settlement refers to the "balance or distribution of power between contending social groups and social classes, on which any state is based" (di John and Putzel 2009:4). Understanding of the central role of political settlement across regions or countries provides relevant insights into the role of institutions and distributions of power. Political settlements may have an effect on legal, economic, and political institutions which may in turn also change the distribution of benefits and development outcomes in society.

Largely, in understanding the mechanisms through which politics and power relations influence poverty and inequality, a political settlements approach focuses primarily on how elites struggle to gain holding power and the ways in which these struggles (and the aftermath) shape vital national institutions, the distribution of public resource and development outcomes (Abdulai 2017). These dynamics of holding power shapes the politics of the provision of basic services, investment in public goods, and the design and implementation of social welfare policies among others (see Evans 1995; Hickey et al. 2015).

Following Khan that two dimensions of power (horizontal and vertical) are important in characterizing the political settlement in a particular country, Khan (2010), identified four important elements of political settlements – vulnerable authoritarian, weak dominant, strong dominant, and competitive clientelist. The vulnerable authoritarian political settlement is characterized by a weak vertical distribution of power (power of low level factions) and a strong horizontal distribution of power (power of excluded factions). In the weak dominant, the vertical distribution is strong whilst the horizontal distribution is weak. In strong dominant political settlements, power is concentrated in the hands of a dominant group or individual (which could be a dominant party or political leader) indicating a weak vertical and horizontal distribution of power. A competitive clientelist political settlement exists where there is a strong vertical and horizontal distribution of power. As a result, in competitive political settlements, there are a number of political parties which contest for power, thus no single political party can be assured of power, as periodic turnovers of the ruling party can happen every time when elections occur.

These four different political settlements present their own and unique nature of struggle for political power. The resultant effect of the struggle and race for power in a particular political settlement largely determine the underlying power arrangements that influence policy, the work of institutions and consequently development. For instance, the political establishment in a competitive clientelist political environment, where the ruling coalition cogitates itself vulnerable to threats from excluded factions with significant holding power, the coalition is more likely to be focused on using institutions of the state to protect short term political gains rather than to equip institutions and distribute resources with a longer-term vision of attaining developmental progress and reduce poverty and inequality. In this case, there is little motivation for political leaders to invest in building quality institutions capable of delivering increased and enhanced development outcomes (Levy et al. 2014). In political settlements where political parties and activities of the elites are funded by business interests that intentionally support campaigns as a way of ensuring lucrative contracts with the state, or possibly worse yet, for

[2] Whaites 2008; Laws and Leftwich 2014; Khan 2012, 2018.

assurances that the state will turn a blind eye to their illegal business practices, this can greatly affect particularly economic and legal institutions, undermining progress toward sustainable development (see Bryan and Baer 2005).

As indicated, there are many studies focusing on the role of institutions and economic growth and development, and the importance of politics and power and institutions, in shaping development outcomes. These studies have largely been argumentative essays focusing on particular countries. Using data compiled on political settlements from the book edited by Pritchett et al. 2017, this paper contributes to the literature by providing a broader empirical/quantitative analysis for a panel of SSA countries on the influence of institutions on income inequality conditioned on prevailing political settlements over the 1996-2010 period. Using disaggregated data on institutions – that is legal, political and economic institutions – we empirically investigate the extent to which political settlements influence the role of institutions on income inequality in African countries. The paper finds that the effects of political, legal and economic institutions conditioned on competitive clientelist political settlements significantly exacerbates income inequality in SSA countries.

Overview of Political Settlements, Inequality, and Institutional quality in Ghana, Liberia, Malawi, Rwanda and Uganda

In this section, we discuss the evolution of political settlements following a classification by Pritchett et al. (2017, Table 1) in five countries in connection with the corresponding levels of institutional quality and inequality. These countries were selected due to the availability of data on political settlements and institutional quality.

Table 1: Evolution of Political settlements in selected countries

Country	Years	Political Settlements[3]
Ghana	1990-98	Strong dominant
	1999-date	Competitive clientelist
Liberia	1990-2005	Strong dominant /competitive (Taylor- Warlordism)
	2006-date	Competitive clientelist
Malawi	1990-1994	Weak dominant
	1994-date	Competitive clientelist
Rwanda	1990-94	Civil war
	1995- date	Strong dominant
Uganda	1990- 2000	Strong dominant
	2000- date	Weak dominant / clientelist

Source: Pritchett et al. 2017

[3] Political settlements for the countries indicates the patterns and evolution of the distribution of power over the years in each country.

All countries in the sample have experienced more than one political settlement over the 1990-2010 period. Out of the five countries, Ghana, Liberia, Malawi are currently undergoing competitive clientelist political settlements whilst Rwanda has a strongly dominant political settlement. With the introduction of multiparty democracy in Uganda in 2005, the political settlement in the country although dominant has become increasingly clientelist. Over the 1990-2010 period, all selected countries have shown highly personalized deals and organizations, with weakly enforced rule of law as captured by the low scores in the quality of legal institutions (Table 2).

Table 2: GDP per Capita (GDPPC), Inequality, and Institutional quality in the Selected Countries, 1990-2010 average

Countries	GDPPC (ppp US$)	Gini Index	Legal	Political	Economic
Ghana	2725	40.8	0.59	0.51	0.47
Liberia	674	37.3	0.33	0.28	0.21
Malawi	917	52.3	0.49	0.48	0.41
Rwanda	1102	47.4	0.27	0.18	0.34
Uganda	1284	43.2	0.46	0.32	0.52

Source: GDPPC from WDI, Gini index from WIID and Quality of Institutions from Kuncic (2014). The indicators for institutions are within country, absolute values for the quality of institutions (and are from a range of 0 to 1, higher values/scores indicating better performance in the measures)

In respect of the subject classification of institutions (see Joskow, 2008), this paper employed three measures of institutions that is legal, economic, and political for the selected countries in an attempt to capture the complete formal institutional environment of the countries in the sample. Legal institutions are the most ubiquitous category of institutions. At least, some form of legislature can be found in virtually any kind of social interactions. Legal institutions vary from public- or state-devised legal institutions to private legal institutions, which are comprehended in contracts. Legal institutions are very important with respect to issues involving property rights, the origins of legal systems and their effects, and enforcement of legislation. Political institutions are institutions that allow broad participation of the citizens of the country, uphold the rule of law, and place constraints and checks on politicians along with the rule of law. Finally, economic institutions are institutions needed to secure a properly working market.

In Ghana, after some initial attempts at overthrowing the Provisional National Defence Council (PNDC) government which came to power in 1981, the PNDC government managed to coagulate its hold on power enjoying support from the lower factions of the people throughout the period with no effective opposition resulting in a strong dominant political settlement. In an effort to find solutions to the myriads of economic problems confronting the country, the PNDC government adopted the Economic Recovery Programme (ERP) in 1981. Although aid immediately started flowing to Ghana with the start of the ERP, donors applied pressure on the

PNDC government to open up the political process (Whitfield 2011). This process gradually led to the return to democratic rule in 1992 and the subsequent creation of competitive clientelist political settlements in the late 1990's. The competitive clientelist political settlements in Ghana over the years have consequently deepened political patronage at the technocratic level of institutions of the state. Mostly, elite incentives are loaded towards the use of public institutions in securing short-term political gains. Therefore, whenever there is a change in the ruling party, wholesale changes in technocratic heads (including public servants perceived to be associated with the previous regime) can be expected. Extreme partisanship in public appointments has been an enduring feature of competitive clientelist political settlement in Ghana. The two dominant parties (New Patriotic Party and National Democratic Congress) see the control of the state as the most lucrative avenue for group and individual wealth and influence. This suppresses the permanency within ministries, government, departments, and agencies of the state, and also makes technocrats less apolitical. Following from the growing strength of vertical distribution of power, local level actors such as party foot soldiers will push for one of their own (usually from their political party) to be appointed to a position of power. They consequently use their power to achieve this critical objective of patronage (Osei et al. 2015). The ideas of political elites in Ghana have been driven largely by political party manifestoes and visions of the leader. Following from the ideology of the political party and vision of the leader, a consultative process is put in place to write a comprehensive party manifesto that would be the blueprint of the party for developing the country if the party wins elections. The campaigns of the political parties during elections are centred around the themes in the party manifesto. These ideas have largely reflected strong faith in markets as a means of allocating resources. This in turn was somewhat driven by development partners using foreign aid to shape ideas around development. As indicated by Appiah and Abdulai (2017), these developments in political settlements reflect the poor levels of institutional quality and its attendant higher levels of inequality as depicted in Table 2.

In Liberia, following from the end of President Samuel Doe's decade in power and the subsequent overrun of the country by militias, the country went through a brutal phase of civil war from 1990 to 2005 – which in effect shattered the economy. Charles Taylor was the most powerful figure in Liberia's political settlements during this period. Taylor used warlord tactics of violence, looting, and highly targeted patronage to exercise control and power over the country (Werker and Pritchett, 2017). Eventually he won contested elections in 1997 before the US and Nigerian intervention ended the war, forcing Taylor into exile in Nigeria in 2003. In Khan's (2010:65) political settlement typology, the horizontal (other warlords) and vertical (anarchic, local militias, and independent bureaucrats and lawmakers) challenges to power place this settlement firmly in the 'competitive clientelism' space, which Khan describes as having 'low enforcement capabilities' and 'short time horizons'. After two years of a kleptocratic transitional government, Ellen Johnson Sirleaf was elected in 2005 and then re-elected in 2011 as president of Liberia. During the reign of Johnson Sirleaf, her appointments and promotion patterns in government followed a mixture of competence, integrity, and loyalty. "When faced with a political challenger, her inclination was to bring them into the tent, rather than face costly opposition from the outside" (Pritchett et al. 2017:61). The political settlement was largely competitive during this period. Using a World Bank supported plan focused mainly on peace and security, revitalising economic activity, governance and infrastructure, President Johnson Sirleaf enlisted the support of a variety of development partners, philanthropists and social impact investors to develop the country. As indicated by Werker and Pritchett (2017) and according to standard indicators, the initial results on governance and especially the measures of state capabilities in the Johnson Sirleaf era, were dramatic However, this shinning success story was not without its limitations. Concerns have usually been raised about the persistent levels of poverty, perpetuation of corruption, and signs of nepotism in the Sirleaf administration.

In Rwanda, it has been generally agreed that the Rwanda Patriotic Front (RPF) government, which took power in 1994 after the genocide, has managed the political pressures very well (see Kelsall 2013; Booth et al. 2014; Collier 2015). This is given the fact that the RPF government inherited a fractured society and was also the first Rwandan government to be dominated by the minority Tutsi ethnic group. The political settlement that has emerged can be categorized as a 'strong dominant party', in the sense that factions excluded from the ruling coalition are relatively weak, as are lower-level factions within the ruling coalition itself (Behuria and Goodfellow 2017). Under the RPF, the strong dominant political settlement – combined with important ideological principles of self-reliance and domestic ownership – has helped to create a rents space with significant scope for firms serving a domestic market that is substantially funded by foreign aid. The RPF embraced market reforms and placed importance on value addition and strategic investments in vital sectors of the economy to propel economic growth and development. Also, the RPF government have focused on the centrality of 'second-generation reforms' which seek to tackle issues such as improving education, expanding social protection, and women's empowerment. These reforms have become one of the important political economic factors underpinning socio economic development in Rwanda. Finally, the RDF government's economic strategy and state –business relationships such as the use of party- and military-owned enterprises to intervene in strategic and long-term ways in the economy lead to an increase in economic growth (see Booth and Golooba-Mutebi 2012). These strategies were aimed at retaining some state control to ensure a continued emphasis on economic transformation and also to maintain a stable political settlement. Behuria and Goodfellow (2017) indicate that these strategic state interventions have influenced Rwanda's development trajectory. However, the RPF government has been subject to criticism regarding limitations on freedoms and human rights (which may reflect the poor improvements in quality of institutions) as well as increased inequality[4] (see Table 2).

The marginalisation of firms operating in the domestic competitive markets (workhorses) as well as exporters in the early 1990's in Malawi under President Hastings Banda provided a window for donors to temporarily undo Banda's rent system, turning the political settlement into a weak authoritarian party system. As a result, the position of political elites came under threat, and succession politics emerged for the first time (see Said and Singini 2017). In 1994, Malawi transitioned to a competitive clientelist political settlement, following the launch of a multiparty democracy. Bakili Muluzi won the presidential elections of 1994 and 1999. In order to build the patronage structure considered essential to win multiparty elections in a competitive clientelist political settlement, President Muluzi during his term in office strategically favoured his religion, ethnic background, and region in the allocation of resources, government contracts such as farm input supplies, medicine supplies and construction among others. This led to a surge in corruption surrounding government contracts and an upsurge in the mismanagement of state resources. In the early stages of President Muluzi's government, he relied on advisors who prioritized development, following from the advice from development partners but subsequently

[4] See Reyntjens (2011) and Ansoms and Rostagno (2012).

he surrounded himself with politicians who had an interest in short-term gains and intended to use state resources, aid, and the development process to stay in power and get rich (Cammack 2011). In 2005, when President Bingu wa Mutharika left Muluzi's party, quoting his anti-corruption campaign, and formed a new party called the Democratic Progressive Party (DPP), many of the ministers and politicians joined the DPP in order to maintain their relations of patronage. This indicates the strength of clientelism in Malawi's political system. Malawi remains stuck with an unfavourable combination of a competitive clientelist system. The poor performance of the country's governance indicators and the high levels of inequality indicate that the near-constant politics of re-election, succession, and patronage seeking continue to take the upper hand over a long-term developmental vision of building vital institutions to propel growth and development.

In Uganda, the political party National Resistance Army (NRA)/ National Resistance Movement (NRM), after a few years of taking power in 1986, successfully introduced a set of power relations and policy ideas which were the inclusive nature of the ruling coalition, and within this a more precise and large-scale 'pro-growth' policy coalition. The NRA/NRM also had a shift of development ideology and a related strategy of encouraging the Asian business community who were expelled by President Idi Amin's government in 1972 to return and restart their enterprises. President Museveni therefore had moved speedily and strategically to form a broad-based ruling coalition (Bukenya and Hickey 2017). In terms of acquiring and safeguarding elite buy-in (or what Khan terms 'managing horizontal power relations'), the process of privatization that was opened aggressively in the mid-1990s was directly used to bind in powerful elites through the distribution of rents in the form of ownership of newly privatized entities (Mwenda and Tangri 2005). Even the policy of encouraging Asian business people to return to Uganda – and of returning their property to them, along with other incentives to help them get the economy moving again – had a political dimension: such concessions came with expectations of political loyalty and financial support for the NRA/NRM, thus further bolstering the capacity of the ruling coalition to remain in power (Bukenya and Hickey 2017). As indicated expressively by Tangri (2015:17), President Museveni has sought to avoid 'the rise of wealthy, autonomous, and assertive black entrepreneurs who emerge outside his ambit and who could challenge his authority. He has viewed them as a potential political threat.' As a result of these policy actions by President Museveni, the political settlements during this period can be described as strongly dominant.

The return of multiparty politics in 2005 in Uganda has resulted in regressive shifts within the political settlement (Golooba-Mutebi and Hickey 2013), suggesting a deepening of clientelistic tendencies. The ruling coalition has become more exclusionary, with the president's ethnic group and the Baganda benefiting disproportionately from the national resources compared with the ethnic groups from northern and eastern Uganda.[5] There has also been several high level defection of elites, many of them have went on to form political parties that raise a formidable threat to the NRM's hold on power due to the president's reluctance to appoint a successor. This intensification of political competition has led to the downgrading of the political settlement from strong to weak dominant. These dynamics within Uganda's political settlement are largely inimical to the prospects of developing the types and quality of institutions associated with

[5] Tumushabe 2009; Tripp 2010; Lindemann 2010.

structural transformation and delivery of enhanced development outcomes (Golooba-Mutebi and Hickey 2013; Kjær 2014). The level of inequality remains high whilst the quality of institutions has stagnated over the period.

Methodology and Data

With respect to the objectives of the paper, we look at the moderating role of political settlements on institutions and inequality. To do this, we specify and estimate the following model:

$$Iniq_{it} = \beta_0 + \beta_1 \mathrm{Inst}_{it} + \beta_2 \mathrm{PolS}_{it} + \beta_3 \mathrm{InstPolS}_{it} + \gamma \mathrm{Z}_{it} + \mu + \varepsilon_{it} \quad (1)$$

where the dependent variable, $Iniq_{it}$ represents Gini inequality for country *i* at time *t*. *Inst* and *PolS* represents institutions and Political settlements respectively. *Inst* measures the quality of institutions in a country. Three measures of institutions, that is, legal, political and economic institutions, are used for the study. *InstPolS* stands for the interaction between institutions and political settlements. This interaction terms capture the effect of institutions on inequality conditioned on a prevailing political settlements. *Z* is a set on control variables that may influence income inequality. These variables include GDP per capita, population and foreign aid. μ and ε_{it} represent country fixed effects and error term respectively.

Drawing largely from historical analysis in the literature, some studies have suggested that economic and political inequality could well impact institutions (Chong et al. 2007; Savoia et al. 2010). Therefore suggesting some form of endogeneity between inequality and institutions. As a result we check using our dataset to find out whether the explanatory variables particularly quality of institutions are correlated with the error term. Due to the absence of correlation between these variables and the error term, we employed fixed effects regression in order to account for unobserved heterogeneity to analyze our data. Also to capture and appropriately explain the interaction terms, we use the *marginsplot* technique.

Description and source of Data

The panel dataset consists of 5 countries: Ghana, Liberia, Malawi, Rwanda and Uganda spanning from 1990-2010. Income inequality is measured using the Gini Index and it is sourced from the World Income Inequality Database produced by UNU WIDER.

The institutional quality scores for legal, political and economic institutions are sourced from Kuncic (2014). Using more than 30 institutional indicators widely used in the literature, Kuncic (2014) computes the latent quality of the 3 institutional types for all countries in the sample. This allows for an effective empirical investigation of countries from a comparative institutional perspective.

Data on Political settlements for the countries over the 1990-2010 period was derived from the book by Pritchett et al. (2017). Political settlement is defined categorically in this paper with values ranging from 0 to 3; the variable assumes a value of 0 for a strong dominant, 1 for a weak authoritative, 2 for a competitive and 3 for a weak dominant. The control variables-foreign aid, population and GDP per capita are sourced from the World Development Indicators, 2017.

Discussion of Results

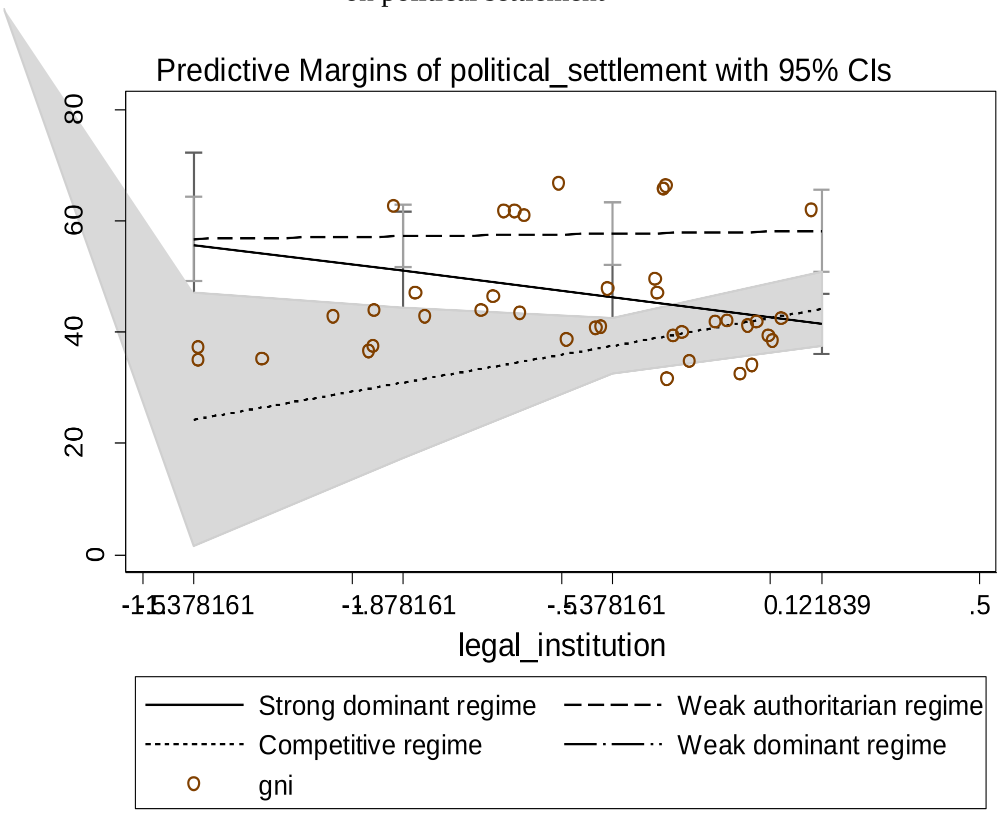
With regards to the discussion of the results, we first examine the direct roles of the three institutional indicators as well as political settlements on income inequality. Then we follow up to investigate the effect of these institutional indicators on income inequality conditioned on prevailing political settlements. We do this by running separate regressions for each institutional indicator- legal, economic and political. We start with a baseline estimation (model 1) looking at the institutional indicators and income inequality. This is followed by an introduction of political settlements in model 2. In model 3 and 4 we augment the model with the interaction terms and control variables respectively.

For convenience we use the *marginsplot* technique to explain the main findings (the interaction terms) from the estimations. The regression estimates are however presented in Tables 1, 2 and 3 in the appendix of the paper. Starting with legal institutions, our results clearly show that improvements in legal institutions would lead to a decline in income inequality albeit this is insignificant. Although the effect of political institutions on income inequality does not seem to be consistent across the models, we find that enhancements in political institutions would significantly lead to reductions in inequality when we include the controls. The effect of economic institutions also seems to have a significant impact in reducing income inequality when we include the control variables. These findings are largely consistent with the literature that improvements in institutions would enhance development outcomes.

Using strong dominant political settlement as the reference category, we evidently find that weak authoritarian political settlements worsens inequality across all the models whilst weak dominant political settlements have no influence on income inequality (compared to strong dominant political settlement). With regards to competitive political settlements, the results show that relative to strong dominant political settlements, the competitive political settlements largely widen the gap in income when we control for population, foreign aid and GDP per capita. In effect, the politics and power relations underlying competitive political settlements may directly impede equality in incomes and sustainable development.

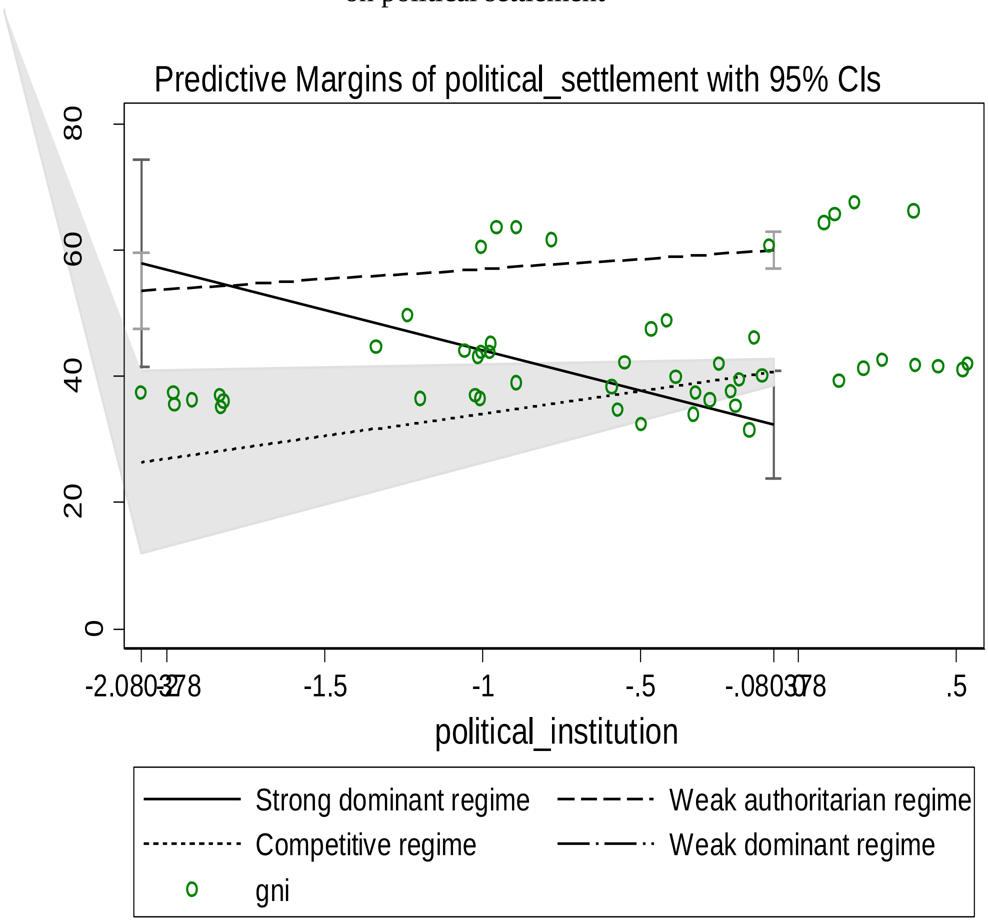
Finally, we focus on the interplay of legal, political and economic institutions and political settlements captured by the interaction terms on income inequality. In this paper, the marginal effect of the institutional variables becomes conditional on the prevailing political settlements. Starting with the legal institutions, the results show that the effect of legal institutions on income inequality contingent on weak dominant and weak authoritarian political settlements is not significant. However, we find that the effect of legal institutions conditioned on competitive clientelist political settlements widens income inequality significantly when legal institutions are weaker but the effect becomes insignificant as the quality of legal institutions improves (see figure 5.1). This indicates that the adverse moderating role of competitive clientelist political settlements on the effect of legal institutions on income inequality is much more momentous when the legal institutions are weak.

Figure 5.1: Estimated effect of Legal institutions on Inequality conditional on political settlement



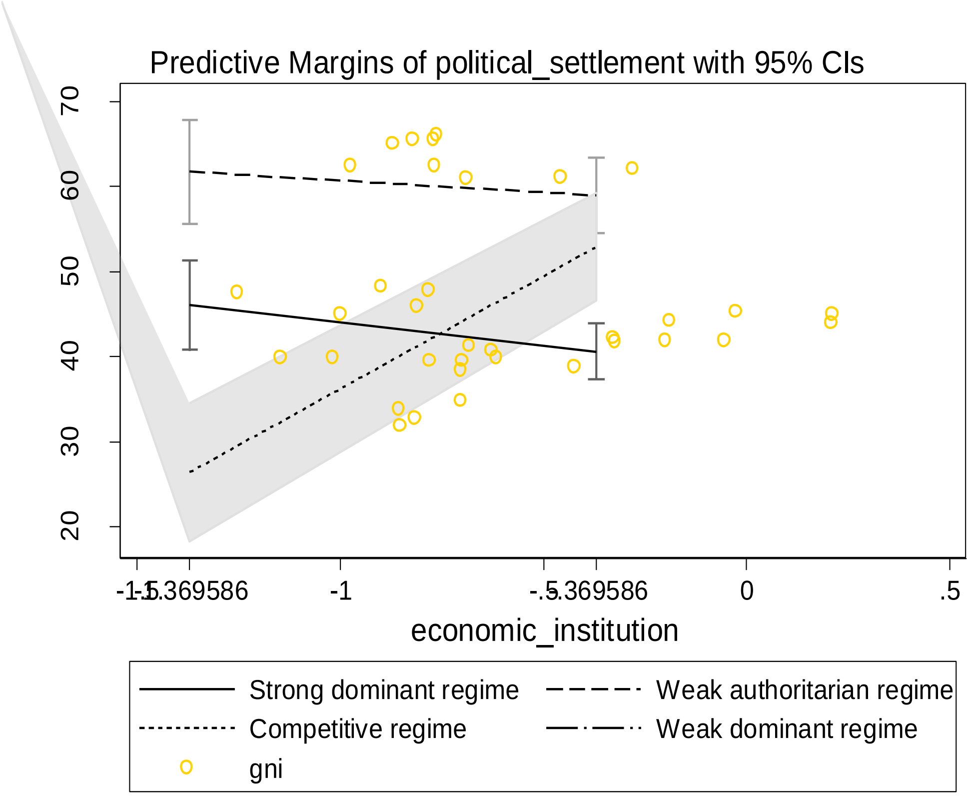
The interaction between political institutions and political settlements indicate that the marginal effect of political institutions conditional on weak authoritarian and competitive political settlement relative to a strong dominant settlement worsen income inequality significantly (see figure 5.2). In effect, weak authoritarian and competitive political settlements harmfully influences the degree to which political institutions affects income inequality.

Figure 5.2: Estimated effect of Political institutions on Inequality conditional on political settlement



Although, weak authoritarian and weak dominant political settlements do not meaningfully impact the degree to which economic institutions affect income inequality, it is evidenced that competitive clientelist political settlements play a significant role in this regard (see figure 5.3). The role of economic institutions such as government agencies involved in ensuring regulatory quality in the economic environment dependent on competitive clientelist political settlements leads to significant increases in income inequality. It is worth noting that the slope for the effect of economic institutions dependent on competitive clientelist political settlement is steepest compared to the other categories of institutions.

Figure 5.3: Estimated effect of Economic institutions on Inequality conditional on political settlement



The results clearly show that competitive clientelist political settlements inhibit the role of legal, political and economic institutions which in turn exacerbate income inequality. This supports the argument by Khan (2018) that the politics and power play in competitive clientelist settlements are associated with "low enforcement capabilities" and "short time horizon" which are detrimental to growth, structural transformation and equality. Situating these findings in the context of the country overviews, particularly countries undergoing competitive clientelist political settlements like Ghana, Liberia and Malawi shows that the detrimental effects of the mediating role of competitive clientelist political settlements can largely be attributed to the politics of holding power. In competitive clientelist political settlements, the threat of being removed from power within an electoral cycle culminates in the politicization of state institutions through patronage appointments and the lack of interest in long term planning and development by the elites and elected politicians. Within these countries, elite incentives are driven towards the use of public institutions in securing short-term political gains, therefore there is little incentive for political leaders to invest in the long-term task of building legal, political and economic institutions. This has often resulted in the politicization of state institutions through patronage appointments, followed by patterns of resource allocation which often appear aimed at maximizing voter support rather than the welfare of all citizens. For instance in Ghana, there is an extreme partisanship in public appointments as the elite see the control of the state as the most profitable avenue for group and individual wealth and influence. This results in adverse implications for the capacity and effectiveness of the state bureaucracy to implement and deliver broad based growth. Also, state institutions particularly those responsible for ensuring regulatory quality for government contracts among others may turn a blind eye to the execution of public projects by a business interest that supports a political party's campaign.

This largely hampers the delivery and quality of many important projects that enhance the welfare of the people.

The continual pressure of electoral competition also counts against developing a focus on the broader public good over the long term. Even when governments express interest in long-term development, they manage this interest in a short-term framework and look out for immediate outputs (Aryeetey 2018). However, the actions of governments in strong dominant political settlements in our sample seem to be geared towards forming broad based ruling coalition resulting in less clientelism. The case of Uganda however shows that the shift from one party to multiparty politics may intensify clientelism resulting in adverse implications for the development of institutions and government effectiveness.

As suggested by Abdulai (2017), this underlying form of politics and power relations emerging from competitive clientelist political settlement may prevent the country from achieving developmental progress in terms of structural transformation which is necessary for poverty reduction and equality. The findings reinforce the growing evidence that developmental outcomes in many poor and developing countries are shaped not so much by the design of institutions per se, but more importantly by the power relationships within which the institutions are embedded. Therefore the dynamics of development outcomes and inequality depend primarily on how the elites respond to the emerging distribution of power (Piketty 2006). The findings present a gloomy picture about the impetus for structural transformation and poverty reduction in SSA countries since the underlying distribution of power in the emerging forms of democracy in the region are becoming increasingly competitive clientelist.

Conclusions and Policy Implications

In this paper, we quantitatively examine the interplay of legal, political and economic institutions, and political settlements on income inequality. We focus on the marginal effect of the institutional variables on income inequality conditioned on political settlements. The findings show that the marginal effect of legal, political and economic institutions contingent on competitive clientelist political settlements exacerbates income inequality significantly. This means that the politics and power play in competitive clientelist political settlements are detrimental to equality and poverty reduction. This is attributed to the politics of holding power which inhibit reforms and quality of institutions, as well as long term investments to promote inclusive growth and development. We surmise that the findings present a gloomy picture about the impetus for the reduction of inequality and poverty in sub- Saharan African countries since the underlying balance of power in the emerging forms of democracy in SSA are becoming increasingly competitive clientelist.

Some authors have argued that many African countries have not adapted democracy appropriately to effectively build institutions that harness elite power to generate the kinds of reforms that support structural transformation and reduction in inequality. This paper indicates the urgent need for SSA countries and development partners to focus on the difficult policy challenge of how to use appropriate governance strategies to develop efficient institutional structures that can harness elite power and use it effectively for the sake of public interest.

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APPENDIX

Table 1: Effect of institutional quality on inequality: exploring the mediating role of political settlement

VARIABLES	(1) Legal institutions	(2) Legal institutions	(3) Legal institutions	(4) Legal institutions
Legal_inst	-2.034	1.205	-3.869	-9.506
	(5.643)	(2.573)	(4.125)	(6.290)
Political settlement (Base: Strong_dom)				
Weak_auth		21.518***	18.424***	15.440***
		(2.808)	(3.863)	(5.017)
Competitive		2.006	4.051	-0.062
		(2.266)	(2.395)	(3.070)
Weak_dom		0.215	0.837	-0.724
		(3.167)	(3.072)	(4.240)
Weak_auth**X**Legal_inst			6.216	10.440
			(5.280)	(6.464)
Competitive**X**Legal_inst			20.488**	22.757*
			(9.841)	(12.245)
Weak_dom**X**Legal_inst			0.000	0.000
			(0.000)	(0.000)
Constant	44.745***	40.636***	40.211***	42.444***
	(2.876)	(1.932)	(2.258)	(7.187)
Other Controls	NO	NO	NO	YES
Country FE	YES	YES	YES	YES
R-squared	0.004	0.815	0.839	0.878
F-statistic	35.16	35.16	26.12	18.39
Number of countries	4	4	4	3
Observations	40	40	40	35

*Notes: Standard errors in parentheses; the dependent variable used in all the estimations presented in this table is inequality, proxied by the gini coefficient; Legal_inst measures the quality of legal institutions in a country; Political settlement is defined categorically in this paper with values ranging from 0 to 3; the variable assumes a value of 0 for a strong dominant regime, 1 for a weak authoritative regime (Weak_auth), 2 for a competitive regime and 3 for a weak dominant regime (Weak_dom); Four different models are presented in this table: first, Model 1 estimates the effect of legal institutions on inequality without the inclusion of other controls; second, Model 2 estimates the individual effects of legal institutions and political settlement on inequality; third, Model 3 estimates the individual effects of legal institutions and political settlement on inequality as well as their interaction effects; finally, Model 4 follows the approach used in Model 3 but with the inclusion of additional controls; Additional control variables included in Model 4 are Gross Domestic Product, Population size, and Foreign aid; *** p<0.01, ** p<0.05, * p<0.1.*

Average Marginal Effects of Legal institutions on Inequality conditional on political settlement

	dy/dx	Delta-method Std. Err.	z	P>|z|
Legal_institution				
Political_settlement				
Strong dominant regime	-9.505	6.289	-1.51	0.131
Weak authoritarian regime	0.934	3.624	0.26	0.796
Competitive regime	13.251	9.604	1.38	0.168
Weak dominant regime	.	(not estimable)		

Table 2: Effect of institutional quality on inequality: exploring the mediating role of political settlement

VARIABLES	(1) Political_inst	(2) Political_inst	(3) Political_inst	(4) Political_inst
Political_inst	1.936	2.525**	-0.464	-12.805**
	(1.629)	(0.974)	(1.213)	(6.225)
Political settlement (Base: Strong_dom)				
Weak_auth		17.474***	20.177***	28.853***
		(2.114)	(2.274)	(4.987)
Competitive		-1.860	2.617	9.944**
		(1.579)	(1.783)	(4.398)
Weak_dom		0.088	0.413	-1.166
		(2.639)	(2.229)	(3.486)
Weak_auth**X**Political_inst			3.577*	16.001**
			(1.785)	(6.327)
Competitive**X**Political_inst			8.170***	19.974***
			(1.871)	(7.242)
Weak_dom**X**Political_inst			0.000	0.000
			(0.000)	(0.000)
Constant	45.130***	43.209***	39.506***	23.842**
	(1.280)	(1.508)	(1.704)	(9.358)
Other Controls	NO	NO	NO	YES
Country FE	YES	YES	YES	YES
R-squared	0.030	0.828	0.883	0.898
F-statistic	51.70	51.70	51.64	29.50
Number of countries	4	4	4	4
Observations	51	51	51	43

Notes: Standard errors in parentheses; the dependent variable used in all the estimations presented in this table is inequality, proxied by the gini coefficient; Political_inst measures the quality of political institutions in a country; Political settlement is defined categorically in this paper with values ranging from 0 to 3;

*the variable assumes a value of 0 for a strong dominant regime, 1 for a weak authoritative regime (Weak_auth), 2 for a competitive regime and 3 for a weak dominant regime (Weak_dom); Four different models are presented in this table: first, Model 1 estimates the effect of political institutions on inequality without the inclusion of other controls; second, Model 2 estimates the individual effects of political institutions and political settlement on inequality; third, Model 3 estimates the individual effects of political institutions and political settlement on inequality as well as their interaction effects; finally, Model 4 follows the approach used in Model 3 but with the inclusion of additional controls; Additional control variables included in Model 4 are Gross Domestic Product, Population size, and Foreign aid; *** p<0.01, ** p<0.05, * p<0.1.*

Average Marginal Effects of Political institutions on Inequality conditional on political settlement

	dy/dx	Delta-method Std. Err.	z	P>|z|
Political_institution				
Political_settlement				
Strong dominant regime	-12.805	6.224	-2.06	0.040
Weak authoritarian regime	3.196	1.498	2.13	0.033
Competitive regime	7.169	3.908	1.83	0.067
Weak dominant regime	.	(not estimable)		

Table 3: Effect of institutional quality on inequality: exploring the mediating role of political settlement

VARIABLES	(1) Economic_inst	(2) Economic_inst	(3) Economic_inst	(4) Economic_inst
Economic_inst	5.291	0.765	-2.342	-5.479**
	(3.845)	(1.875)	(1.712)	(2.346)
Political settlement (Base: Strong_dom)				
Weak_auth		21.189***	15.571***	19.364***
		(3.046)	(3.950)	(4.252)
Competitive		1.929	12.615***	24.132***
		(2.428)	(2.936)	(6.281)
Weak_dom		0.115	1.121	0.363
		(3.425)	(2.594)	(3.640)
Weak_auth**X**Economic_inst			-1.804	2.698
			(4.351)	(4.873)
Competitive**X**Economic_inst			16.825***	31.964***
			(3.601)	(7.131)
Weak_dom**X**Economic_inst			0.000	0.000
			(0.000)	(0.000)
Constant	50.341***	41.176***	40.958***	24.070***
	(2.662)	(2.337)	(1.808)	(7.675)
Other Controls	NO	NO	NO	YES
Country FE	YES	YES	YES	YES
R-squared	0.058	0.814	0.903	0.929
F-statistic	30.73	30.73	40.18	33.69
Number of countries	3	3	3	3
Observations	35	35	35	35

Notes: Standard errors in parentheses; the dependent variable used in all the estimations presented in this table is inequality, proxied by the gini coefficient; Economic_inst measures the quality of economic institutions in a country; Political settlement is defined categorically in this paper with values ranging from 0 to 3;

*the variable assumes a value of 0 for a strong dominant regime, 1 for a weak authoritative regime (Weak_auth), 2 for a competitive regime and 3 for a weak dominant regime (Weak_dom); Four different models are presented in this table: first, Model 1 estimates the effect of economic institutions on inequality without the inclusion of other controls; second, Model 2 estimates the individual effects of economic institutions and political settlement on inequality; third, Model 3 estimates the individual effects of economic institutions and political settlement on inequality as well as their interaction effects; finally, Model 4 follows the approach used in Model 3 but with the inclusion of additional controls; Additional control variables included in Model 4 are Gross Domestic Product, Population size, and Foreign aid; *** p<0.01, ** p<0.05, * p<0.1.*

Average Marginal Effects of Economic institutions on Inequality conditional on political settlement

	dy/dx	Delta-method Std. Err.	z	P>|z|
Economic_institution				
Political_settlement				
Strong dominant regime	-5.478	2.346	-2.34	0.020
Weak authoritarian regime	-2.780	3.910	-0.71	0.477
Competitive regime	26.485	7.129	3.71	0.000
Weak dominant regime	.	(not estimable)		