



Diversity and the power of the elites in democratic societies: Evidence from Indonesia

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ABSTRACT

This paper analyzes whether political outcomes in local democracies are determined by the preferences of the median – typically poor – agents or whether they reflect the wishes of the wealthy elites. Theory suggests that when politicians belonging to different groups can form coalitions, the wealthy elites' influence on policy choices is endogenously higher when there is diversity in preferences among the poor. The pattern of public good provision by local governments in Indonesia is consistent with this intuition. Our analysis indeed shows that when individuals have different preferences – here due to different ethnicities – democratic policy outcomes are closer to the preferences of the elites, rather than the preferences of the poor majority.

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1. Introduction

Democracy is generally deemed to be good for the poor; since the elites are few while the poor are many, common wisdom suggests that democracy will lead to the choice of policies that reflect the preferences of the poor. The comparison, however, becomes less straightforward when citizens' preferences for public policies differ along dimensions other than those deriving from differences in wealth. Examples include differences due to religious beliefs, ethnic interests, geography or culture. In this paper we present evidence on the allocation of public goods in Indonesian villages, using differences in ethnicity as a measure of preference diversity.

Our theoretical motivation is based on a model presented by Bandiera and Levy (2010).¹ We show there how preference diversity among the poor endogenously gives weight to the preferences of the elites in the choice of public goods. In the absence of such diversity, and in the spirit of “median voter” results, general public goods may be provided. Diversity of preferences among the poor however, can give rise to other outcomes. In particular, we show that rich elites and poor ethnic or other minority group can form stable coalitions that provide group-specific public goods that both the elites and the ethnic group prefer to the provision of general public goods. Thus, even in fully functioning democracies, where the elites have no additional powers and all votes have equal weight,

policy choices may reflect the preference of the elites rather than those of the poor.²

We provide evidence on the allocation of public goods by local governments in Indonesia. Motivated by this theoretical framework, the empirical test requires information on the viability of the coalition between the elites and a poor minority and on preference diversity across wealth classes, which we assemble by exploiting two distinctive features of the Indonesian context.

First, Indonesia is one of the world's most ethnically diverse countries and ethnic composition varies even within small geographical areas, so that some local constituencies are ethnically homogeneous while in others the dominant ethnic group barely constitutes a majority. Given that ethnicity is often mentioned as a leading source of preference heterogeneity and ethnic diversity is a salient issue in the Indonesian context, we use the population share of the ethnic minority to proxy for the probability that there is a minority group with whom the elites can form a ruling coalition.

Second, customary “adat” laws create natural differences in governance structure at the smallest political unit—the village. At one end of the spectrum, there are villages in which decision making is entirely controlled by the elites; at the other end, decisions are taken democratically in community meetings. While the tastes of the elites are not observable, a revealed preference argument indicates that outcomes reached when the elites control decision making must be preferred by the elites.

² These ideas are complementary to Acemoglu and Robinson (2006) who propose a model in which citizens and elites can invest resources in order to acquire *de facto* political power which allows them to change economic or political institutions in their favor. In Bandiera and Levy (2010) we propose a particular political mechanism through which elites gain such power endogenously.

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¹ See also Levy (2004, 2005) and Fernandez and Levy (2008).

To test whether diversity among the poor is correlated with outcomes that are closer to the preferences of the elites, we then test whether the difference in the provision of a range of public goods between villages in which decision making is entirely controlled by the elites and democracies is affected by the level of ethnic diversity, which determines whether a coalition is viable. The analysis yields two key findings.

First, the difference between the preferred level of public goods by the elites and the majority poor, is negative for some goods (education and health), positive for others (public security and voluntary labor programs) and zero for a third group (utilities and infrastructure services).

Second, and most importantly, we find that for all the goods over which the difference is non-zero, increasing the share of the ethnic group brings the allocation closer to the preferred outcome of the elites. The effect is large in magnitude. For instance, compared to villages where the elites control decision making, the number of health clinics per 1000 inhabitants is 12% higher in ethnically homogeneous democracies, while the difference falls to 6% at the mean minority share. In line with our interpretation that increasing the share of the ethnic group allows the elites to have more influence on public choices, we find that for all the goods over which the elites and the majority preferences are aligned, ethnic diversity is not correlated with public good outcomes.

Our empirical analysis may point towards some more general insights on two fronts. First, we highlight a political mechanism through which diversity can affect public policy (namely, by enabling the elites to form winning coalitions) and our empirical analysis provides some clues that allow us to distinguish this mechanism from alternative channels.³ For example, we find no support for models that predict an unambiguously negative effect of diversity on the level of public good provision, for instance because individuals dislike contributing resources to goods that benefit members of other ethnic groups. Indeed, we find that the sign of the effect of diversity differs across a range of public goods. In particular, the level of public goods preferred by the elites is *higher* in more diverse communities. Moreover, the finding that the effect of diversity does not depend on whether people of different groups need to consume it together – as in the case of education – or not – as in the case of health facilities – does not lend support to the assumption that diversity reduces public good provision because individuals dislike interacting with others belonging to different groups.

Second, we bring some new evidence on the debate of the effect of democracy on public policies. The cross-country evidence indicates that democracies and non-democracies look remarkably similar on a large set of public policies (Mulligan et al., 2004). Our analysis highlights one channel suggesting that the effect of democracy might be heterogeneous, as a function of preference diversity among the poor. If, due to diversity, the elites can rule in a democratic society, its outcomes will not differ from autocratic regimes where power is concentrated in the hands of the elites.⁴

We present the theoretical motivation in Section 2. The empirical analysis is in Section 3, while Section 4 concludes.

2. Diversity and the power of the elites: theoretical motivation

We now present a theoretical motivation for our empirical analysis, in line with the model we provide by Bandiera and Levy (2010).⁵

³ For a comprehensive review of other channels and the empirical literature, see Alesina and La Ferrara (2005).

⁴ To the best of our knowledge, only Collier (2000) analyzes the interaction between diversity and governance, but he focuses on its effects on growth rather than public policies. See also Przeworski and Limongi (1993) and Barro (1996) for an analysis of the effect of democracy on growth, Rodrik (1999) on wages, Persson and Tabellini (2006) on political regimes and growth, and Besley and Kudamatsu (2006) and Kudamatsu (2007) on health outcomes.

⁵ By now there exist a substantial body of literature exploring the effect of diversity on public good provision (e.g., Alesina et al., 1999; Roemer, 1998; Llavador and Oxoby, 2005; Levy, 2005; Fernandez and Levy, 2008). We survey this literature in Bandiera and Levy (2010).

Suppose that the poor in society share the same preferences over redistribution. Naturally, being the majority in most populations, standard democratic processes will give rise to decision making in society being in line with the preferences of the poor. In most environments however, even if all the poor agree on how much revenues the government should raise, preferences over how to spend these revenues or transfers from the central government differ between different groups (as well as among rich individuals or those belonging to the elite). Such differences can arise for example due to geographical locations, or diversity in ethnicity or religion. For example, individuals belonging to the ethnic or religious minority may prefer public provision of the minority language programs in school or, lacking own funding, that the government will subsidize building their own particular place of worship.

The model analyzes decision making in a society made of two main groups: the wealthy elites (a minority) and the poor (a majority), who have different preferences over public goods. The defining features of the political process are that politicians from the different groups in society form parties, parties offer platforms, and voters vote for the platform they like most. An important assumption in the model – in the spirit of the citizen candidate models – is that parties can only offer credible policies, i.e., policies that are in the Pareto set of its members. The prediction of the model is a political equilibrium in which an array of stable parties and platforms arises (i.e., no politicians wish to split their party and no parties wish to change their platforms).

We distinguish between a simple environment in which all the poor have the same preferences and an environment in which a minority segment of the poor, which we refer to as the ethnic group, have different preferences. The model illustrates that the ideal policy of the poor majority is unambiguously chosen in equilibrium only if politicians belonging to different groups cannot form parties. Once they do, the rich elites and the ethnic group can form a stable coalition that wins by offering a combination of public goods that both the elites and the ethnic group prefer to the ideal policy of the poor. Such coalition implements a policy of lower provision of general public goods but instead some provision of the ethnic good and goods which the rich like (e.g., policing services). Thus, although the poor groups together are a majority, the rich manage to take advantage of the diversity of preferences among the poor in their favor.

We then conclude that in diverse democracies, the level of provision of general public goods is lower, whereas the provision of targeted and specific goods is higher and tilted towards the preferences of the elite. In the next section we test whether indeed the share of the ethnic minorities affects the ability of the elites to sway the political outcomes in their favor.

3. Diversity and the power of the elites: public goods in Indonesian villages

This section presents evidence on Indonesian local governments' outcomes at the smallest political level: the village. The first subsection describes the context and our identification strategy. The second presents the empirical findings. The third discusses alternative interpretations.

3.1. Context and identification

Our data source is the 1997 Indonesian Family Life Surveys (IFLS 2). The distinctive feature of IFLS2 is that it contains detailed information on governance, on a large range of public goods and community activities and on ethnic composition at the village level. The sample covers 259 villages in 35 districts out of the 243 districts of Indonesia.

In the sample period, the village government was responsible for several public goods and infrastructure projects. These included the maintenance and construction of sewage systems, water pipes, health posts and classrooms. Village expenditures were financed by a central

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