

## ENDOGENOUS CONSTITUTIONS\*

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We present a theory of the choice of alternative democratic constitutions, a majoritarian or a consensual one, in an unequal society. We show that a consensual system turns out to be preferred by society when *ex ante* income inequality is relatively low, while a majoritarian system is chosen when income inequality is relatively high. We also find that consensual democracies should be expected to be ruled more often by centre-left coalitions while the right should have an advantage in majoritarian constitutions. The implications for the relationship between inequality and redistribution are discussed. Historical evidence and a cross-sectional analysis support our results.

In recent years, there has been an increasing interest in the political economics literature for the role of key constitutional norms in shaping fiscal policy outcomes. Important theoretical contributions include, among others, Myerson (1993), Persson *et al.* (1997, 2000), Persson and Tabellini (2000), Austen-Smith (2000), Lizzeri and Persico (2001) and Milesi-Ferretti *et al.* (2002), and generally predict that proportional electoral systems and parliamentary regimes should be associated with more provision of public goods and universalistic welfare programmes, as well as with larger size governments. These results have been confirmed by some recent empirical works. Persson and Tabellini (2003, 2004) present cross-country evidence suggesting that a switch from proportional to majoritarian elections reduces total government spending by almost 5% of GDP and welfare spending by 2–3% of GDP, and obtain similar results for a switch from a parliamentary to a presidential regime. Milesi-Ferretti *et al.* (2002), Lijphart (1999) and other works provide empirical evidence going in the same direction.

These contributions are based on the premise of taking political institutions as given. But if different constitutional provisions lead to different fiscal policies and, therefore, generate different benefits for the various groups in the society, we should expect individuals to have different preferences over constitutions and take this into account at the time of the constitutional choice. In this article, we start from the consideration that the various groups in the society may have conflicting interests over constitutions and provide an economic theory of the choice of a democratic constitution on the base of the (pre-tax) distribution of income within a society.<sup>1</sup> In other words, we recognise

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<sup>1</sup> The focus on the distribution of income is motivated by the insights provided by the positive political economics theory of taxation and redistribution in democracies (Romer, 1975; Roberts, 1977; Meltzer and Richard, 1981), which stresses the importance of this variable in shaping fiscal policy outcomes when individual preferences are aggregated directly by majority voting. The class conflict perspective over different institutional frameworks and the key role played by income inequality have been first emphasised by Acemoglu and Robinson (2000) in their analysis of democratic transitions.

that constitutions are endogenous and their choice affected by economic fundamentals.

Whereas constitutional models differ along several dimensions, in our analysis we focus on the electoral system as this is generally considered one of the most important constitutional provisions, at least from a fiscal policy outcome perspective. As pointed out by Lijphart (1999), in parliamentary regimes the electoral system leads to two distinctive types of democratic models. One is the *majoritarian* model characterised by a majoritarian (plurality rule or first-past-the-post) electoral system that generally leads to the formation of a two-party system and to the concentration of power in the hands of the prime minister. The other is the *consensual* (or proportional) model which is characterised by a proportional electoral rule leading to a multi-party system and, therefore, to coalition governments.<sup>2</sup> While our theoretical model represents precisely these two types of parliamentary regimes, at some point we argue that our model of majoritarian democracy may also well describe presidential regimes where the president has relatively large legislative powers.

Our main result is that a majoritarian constitution is more likely to be chosen when the degree of income inequality is relatively high, while consensual democracy is more likely to arise in relatively homogeneous societies.

We present a simple public finance model where fiscal policy is about the provision of some public goods, financed with proportional taxation of income. The public goods considered are local, or group-specific, in the sense that each of them is desired by one and only one of the three social groups (or 'classes') which compose the society and that are identified by their level of pre-tax income: the poor, the middle class and the rich. We go on by characterising the political equilibrium of the model in a majoritarian and in a consensual democracy respectively. A key assumption that we maintain in each constitutional environment is that politicians are citizen-candidates who have a direct interest in the policy implemented and cannot credibly commit to implementing any policy different from their preferred one.

We assume that fiscal policy in a majoritarian democracy is decided by a 'leader' elected directly by the people through a majority voting process. We demonstrate that in equilibrium the winner is always a rich citizen-candidate as the rich enjoy a natural advantage over the other two classes, arising from the interaction of their relative fiscal conservatism and the majoritarian electoral law, and conclude that the structure of majoritarian democracy biases policy outcomes in favour of this group.

In a consensual democracy fiscal policy is decided by a coalition government formed as the outcome of some legislative bargaining process among the members of a parliament elected with a proportional electoral law. We show that the government coalition depends on the distribution of income. According to our model, in a consensual democracy a middle class and rich (middle class and poor), or centre-right (centre-left), government coalition is more likely to be formed when the distribution of income is more (less) polarised. We also show that taxation and the size of government in a consensual democracy under a centre-left coalition are higher than under a

<sup>2</sup> It is worth emphasising that the features of the majoritarian model, typically represented by the UK, also lead to a dominance of the executive over the legislative power, while in consensual democracies, widely observed in continental Europe, the distribution of power between the executive and the legislative power is more balanced.

centre-right one, and that they are generally higher in a consensual than in a majoritarian democracy.

Finally, we evaluate the welfare implications of the two types of political institutions from the point of view of the different groups of citizens and let individuals vote in an 'original position' in the absence of any veil of ignorance on which constitution to adopt. We find that a society with high income inequality prefers a majoritarian constitution while consensual democracy is preferred when inequality is lower. The intuition behind this result is simple. The rich prefer the majoritarian system because they always get to power. The middle class prefer the consensual model as it is always part of the government coalition. Hence, the poor are the swing voters. When inequality is low, they end up being part of the government in consensual democracy and will therefore prefer this political system. When inequality is high, the poor are not part of the government in the consensual system and then prefer the majoritarian one. They do not get their specific public good in any case but the rich under majoritarian democracy tax them less than the middle class and rich coalition.

The main prediction of our article, that more unequal societies are expected to choose a majoritarian constitution while more equal countries opt for a consensual one, is tested with a cross-sectional analysis in a sample of 57 democracies and in a sub-sample of 31 parliamentary democracies. To avoid problems of endogeneity, we use the income inequality at the time of (or before) the adoption of the constitution and find that, as predicted by our theory, the degree of inequality is a highly significant determinant of constitutional choice.

The model has also other important implications concerning the politico-economic outcomes in representative democracies. In accordance with the existing literature, we obtain that taxation and the size of government in consensual democracies are higher than in majoritarian ones. However, the mechanism generating this result in our model is new and due to a *selection bias* in the composition of the government coalition. Consensual democracies should be expected to be ruled relatively often by centre-left coalitions, more willing to tax and redistribute income, while the more fiscally conservative right should have an advantage in majoritarian countries. We also emphasise that our constitution selection theory may shed some light on the relationship between inequality and redistribution, suggesting that the former not only affects fiscal policy for a given constitution, but it also influences the choice of the constitution itself. As a result, the relationship between income inequality and redistribution may well be absent or negative as suggested by the empirical evidence (Perotti, 1996) and contrary to the results obtained by models based on the median voter.<sup>3</sup>

As explained above, our theory also provides a clear prediction about the preferences of the social groups for the type of constitution. We present some historical evidence that is in accordance with our findings. In particular, we present evidence that the constitution of the US has been drafted to reflect essentially the interests of the economic elite of the time, and something similar happened in other majoritarian democracies such as the UK and Chile. We also discuss the adoption of consensual

<sup>3</sup> Our theory implies that more unequal countries are expected to choose a majoritarian model where redistribution is low, while more equal societies are expected to adopt consensual constitutions that lead to more redistributive outcomes.

constitutions by several continental European countries and argue that, in accordance with our theory, in most cases this choice was made by centre-left forces in a period of low and/or declining income inequality.

Although this article contains various interesting results, its main contribution to the literature is to provide a theory of constitutional choice, highlighting the endogeneity of political institutions and the role played by economic fundamentals in this choice. Such fundamentals, in our case income inequality, are themselves affected by the constitutional rules through their effect on fiscal policy outcomes. By clarifying the endogeneity and the factors behind the choice of a constitution, our theory may offer guidelines for future empirical research to the literature on the economic consequences of constitutions. Our article is also related to the recent literature about the choice of voting rules (Aghion and Bolton, 2003; Barbera and Jackson, 2004; Messner and Polborn, 2004) and other political institutions (Acemoglu and Robinson, 2000; Aghion *et al.*, 2004).

The article is organised as follows. Section 1 describes the basic economic setting and the public finance problem we focus on. Sections 2 and 3 present the political equilibrium of the model in majoritarian and consensual democracy respectively. Section 4 characterises the properties of the political equilibrium within and across constitutions. Section 5 deals with the key issue of the endogeneity of the constitution and its relation with the distribution of income. In Section 6 we discuss the intermediate results of our theory and present evidence supporting them. Section 7 shows the results of our cross-sectional analysis on the relationship between income inequality and constitutional choice. Section 8 concludes.

## 1. A Simple Model of Public Finance: Basic Setup

We consider a simple model of ‘local’ (that is, group specific) public goods provision based on Persson and Tabellini (2000, ch. 7). A society is made up by  $N > 1$  groups of individuals. For convenience, we focus on the case where  $N = 3$ . Group  $j \in \mathfrak{S} \equiv \{p, b, r\}$  has size (measure)  $m^j$  and each individual of that group has an exogenous pre-tax income equal to  $y^j$ . Total population is made by a continuum of unitary measure  $\sum_{j \in \mathfrak{S}} m^j = 1$  and with no loss of generality we assume that  $\max\{m^p, m^r\} < m^b < 1/2$  and that  $y^p < y^b < y^r$ . This means that group  $b$  is the largest one and has an intermediate level of income, so that it is natural to identify it with the ‘middle class’. Group  $p$  and group  $r$  correspond to the ‘poor’ and to the ‘rich’ people. The absolute majority of votes is reached by the combination of any pair of groups. Notice also that the above assumptions are sufficient to ensure that the voter with median income (i.e. the median voter if preferences are single-crossing in income) belongs to group  $b$ . Finally, we assume that  $y^b < \bar{y} \equiv \sum_{j \in \mathfrak{S}} m^j y^j$ : the voter with median income is poorer than the (virtual) mean voter, which means that the distribution of income is skewed to the left consistently with the empirical evidence.

We assume that the utility function of each member of group  $j$  has the following quasi-linear form

$$w^j = c^j + H(g^j) \quad (1)$$

where  $c^j$  denotes the consumption of a private good and  $g^j$  the level of the type  $j$  public good provided.  $H(\cdot)$  is a smooth, increasing and concave function that satisfies the

Inada conditions.<sup>4</sup> We also assume that  $H(0) = 0$ . The Inada conditions guarantee that at the optimum each group will always strictly prefer to have some taxation and some provision of its desired public good to the alternative of no taxation and no public good. All the above properties are satisfied by the constant elasticity functional form  $H(g^j) = A(g^j)^\alpha$ , where  $A$  is a constant and  $\alpha \in (0,1)$ . At some point we will use such preference specification to obtain some analytical and numerical results.

Each group is perfectly homogeneous. Heterogeneity is only between groups and is related to the differences in the pre-tax income level and to group-specific preferences on the public good to be provided. The specification of preferences in (1) implies that each group values one particular public good only and there are as many kinds of public goods as the groups of people. The local public goods can be interpreted as publicly provided private goods, like education, health and housing, on which different income groups have different preferences.<sup>5</sup> However, the important implication of our specification of individual preferences is that redistribution can be targeted toward specific social groups.<sup>6</sup>

Income is taxed at a proportional rate  $\tau \in [0,1]$  that will be determined later as a part of the political equilibrium of the model. Therefore, the budget constraint of the agents of group  $j$  is simply  $c^j = (1 - \tau)y^j$ . We also assume that the government can finance public expenditures only out of the revenues generated by income taxation. In equilibrium,  $g^j$  is positive only when group  $j$  is part of the government. If we incorporate this result in the public sector budget constraint, the latter can be rewritten as  $\sum_{j \in \Omega} g^j \leq \tau \sum_{j \in \mathfrak{S}} m^j y^j = \tau \bar{y}$ , where  $\Omega \equiv \{j \in \mathfrak{S} : j \text{ is part of the government}\}$ .

As will become clear later, the quasi-linearity of preferences and the assumption of no tax discrimination simplify the analysis. Our results generalise as long as higher income levels translate into a preference for lower tax rates and groups in power cannot raise tax rates on other groups only. Our results would no longer go through if the group in power could impose a tax rate on other groups that is independent of the one that applies to itself (in this case the group in power could fully expropriate any other groups).

In the next two Sections, we derive and characterise the political equilibrium of our model, namely the tax rate  $\tau$ , the overall level of public expenditure and its composition  $G \equiv (g^p, g^b, g^r)$ , in the case of both a majoritarian constitution and a consensual one. Since the constitution is at this stage still taken as given, these equilibria can be considered as partial political equilibria. Then, we characterise the general political equilibrium where the constitution will be itself endogenous and chosen by the society.

We assume that voting is sincere in any constitutional environment and model the political process going on within a majoritarian or a consensual democracy drawing on

<sup>4</sup> This means that  $H_g(\cdot) > 0$ ,  $H_{gg}(\cdot) < 0$  and  $\lim_{g^j \rightarrow 0} H_g(g^j) = \infty$ .

<sup>5</sup> See for example Besley and Coate (1991) who show that, allowing for different quality levels of the public goods, a *de jure* universal provision scheme does not imply that it is *de facto* universal and explain why some publicly provided private goods like health care may go to the advantage of the poor and not to the rich. Fernandez and Rogerson (1995) also discuss the case of higher education and emphasise how the public provision of it can benefit higher-income individuals at the expense of the poor.

<sup>6</sup> It can be shown that the main results of the article are robust to a more general specification of individual preferences and of the menu of the fiscal policy instruments available. If, for example, the members of a social group obtain some utility also from the provision of the other public goods, or there is a general public good providing utility to all individuals, the main results of the article would still hold as long as the taste for the group-specific public good is strong enough; see for further details Ticchi and Vindigni (2003).

the citizen-candidate apparatus of Osborne and Slivinsky (1996) and Besley and Coate (1997).<sup>7</sup> We adopt a model of endogenous political candidacy since we want to emphasise the link existing between individual preferences (of citizens as well as of politicians) and individual income. Moreover, a key advantage of this model is to allow for the existence of an equilibrium even when individual preferences fail to be single-peaked.<sup>8</sup>

## 2. Majoritarian Democracy

We assume that in a majoritarian democracy fiscal policy is decided by a ‘leader’ elected directly by the people through a majority voting process among the menu of citizen-candidates participating to the election. With this assumption, we mean to capture the winner-takes-all nature of political competition going on within a majoritarian democracy. Thus, the model represents both a parliamentary democracy where the legislature is elected with a majoritarian electoral rule (e.g. the UK), a presidential regime with a legislative assembly elected with a majoritarian electoral law (e.g. the US) and a presidential regime where the president plays a very important role in the legislative process (which is typically the case in Latin America).<sup>9</sup>

The menu of candidates is endogenous and one individual runs for office if and only if, in equilibrium, the net gain of doing so (the difference between the utility he gets if does-not run) exceeds the exogenous cost of running. The winner of the election is the candidate gaining the plurality of votes and he alone decides on fiscal policy.

To characterise the political equilibrium under a majoritarian constitution, it is useful to start from the benchmark case of the unconstrained preferred policy of each social group. Then, suppose that a member of group  $j$  (which one is irrelevant given the assumption of perfect within group homogeneity) could act as a dictator and implement his preferred policy (‘dictatorial policy’). It is clear that he would not spend anything in any public good other than his preferred one, so that  $g^i = 0$ ,  $i \neq j$  and  $g^j = \tau \bar{y}$ . Hence, he would maximise the following utility  $w^j = (1 - \tau)y^j + H(\tau \bar{y})$ . The (unique) optimal dictatorial tax rate of group  $j$  that solves this problem is<sup>10</sup>

$$\tau^j = \frac{H_g^{-1}(y^j/\bar{y})}{\bar{y}}. \quad (2)$$

<sup>7</sup> Osborne and Slivinsky (1996) assume sincere voting while in Besley and Coate (1997) individuals are strategic. In this sense our model is closer to the first one.

<sup>8</sup> This is a potentially serious problem in our model since the policy space is multidimensional and, thus, voting cycles may occur. The citizen-candidate model allows us to avoid the problem of non-existence of an equilibrium. At the same time, we are able to show that the main drawback of it, namely the generic multiplicity of political equilibria, is not an issue in our economy.

<sup>9</sup> Our theory suggests that because in the US both the legislature and the president are elected with the same electoral law, their preferences over fiscal policy should be relatively similar and ‘divided government’ (Alesina and Rosenthal, 1996) should not be of central importance in this respect. Also, in an extension of our model (available from the authors), we show that essentially the same political equilibrium carries over in an institutional environment where, as in Latin America, the president has relatively large legislative powers (including setting the agenda and vetoing bills) and the assembly is elected with proportional representation (PR). We therefore conclude that fiscal policy outcomes in presidential regimes with PR depend primarily on the nature of the electoral law of the president.

<sup>10</sup> It is immediate to verify that the second order condition is satisfied. The Inada conditions imposed on  $H(\cdot)$  imply that the tax rate is always strictly positive.



It is straightforward to verify that  $\partial\tau^j/\partial y^j < 0$ . The richer a group  $j$  member is (for a given mean level of income), the higher is the marginal cost of public good provision he faces and the lower is his demand for his preferred public good. Hence, the dictatorial tax rates for the three groups can be ordered as:  $\tau^r < \tau^b < \tau^p$ .

No commitment technology is assumed to be available and, therefore, candidates cannot announce credibly before the election to pursue, if elected, any policy different from their preferred one. Let  $k$  denote some private benefit of being in office, which is either a psychological benefit or a non-taxed monetary income, and  $\varepsilon$  be the cost of running. Both are exogenous and equal for everybody with  $k \geq \varepsilon$ . Now, we can state the main result of this Section.

**PROPOSITION 1.** *The model has a unique political equilibrium with the following features. Only rich citizen-candidates run for office, only the public good preferred by the rich is provided and the dictatorial tax rate of the rich  $\tau^r$  is implemented.*

*Proof.* See Appendix.

There are four elements of the model that are important for the results of this Proposition. First, no one group has the majority of the votes alone. Second, the utility function is chosen in such a way that the rich, as dictator, is the group that prefers the lowest taxes. Third, the winner-takes-all nature of the electoral process: in two-candidate contests between the rich and another group, the rich always win since they prefer less taxation.<sup>11</sup> Fourth, if a group expects to lose an election, no candidate is forthcoming.

### 3. Consensual Democracy

In a consensual democracy voters do not elect a leader directly but rather elect their representatives to the parliament. We assume the existence of a parliament composed by a continuum of measure  $\rho \in (0,1)$  of members which are elected with a pure proportional electoral rule in a single nation-wide electoral district. The government is formed as the outcome of a process of legislative bargaining among the representatives of the different groups and it expresses a certain parliamentary majority.<sup>12</sup> We also assume that the plurality of parliamentary votes is sufficient to form a government.

The policy formation process corresponds to the following three-stages game:

- (1) the entry of candidates stage;
- (2) the voting stage;
- (3) the legislative bargaining stage.

Assuming that there are three groups in the parliament and that no group has the absolute majority of parliamentary members (which will be the case in equilibrium), events take place at the legislative bargaining stage according to the following protocol.

<sup>11</sup> This implies that, *off-equilibrium*, it is possible to observe an ‘extreme coalition’ made up by the rich and the poor. As it is clear from the proof of Proposition 1, in case there is a rich and a middle class candidate, the poor prefer to vote for the rich since the latter’s fiscal conservatism is the best alternative they have.

<sup>12</sup> In modelling the legislative bargaining process taking place in a consensual democracy, we partly draw on the agenda-setting model of Romer and Rosenthal (1979), as well as on the model of legislative decision making in a three-party proportional representation system offered by Austen-Smith and Banks (1988).

- *Round 1 of the bargaining game:* the head of the representatives (appointed at random) of the group having the relative majority of seats in the parliament is called to make a policy proposal to the head of the representatives of another group of his choice. Given that ‘buying’ votes is costly, only two groups coalitions will be observed and a version of Riker’s minimum size coalition principle will apply.
- If the proposal is accepted, the government coalition is formed and the agreed policy is implemented.
- *Round 2 of the bargaining game:* if the proposal is not approved, a second agenda setter is appointed randomly by nature between the representatives of the two groups of which no member was agenda setter at round 1. More precisely, a member of either of these groups is appointed as agenda setter at round 2 with probability equal to the share of the parliamentary seats of his group, relative to the total number of seats of the two groups. Then, the second agenda setter has the opportunity to form a government and formulates a coalition proposal to another group of his choice.
- If no proposal is approved at round 2, the game ends and the *status quo* policy is implemented. We assume that the *status quo* policy corresponds to no taxation and no public goods provision.

Notice that our modelling of the policy-making process in a consensual democracy is innovative in at least two dimensions. First, we study a legislative bargaining process between citizen-candidates representatives. Second, we analyse how the distribution of income shapes fiscal policy outcomes through the non-standard channel of the bargaining power of the different classes, which is endogenous and turns out to depend on the income distribution itself.

### 3.1. *Entry of Candidates, Voting and Bargaining*

The equilibrium of the policy formation game must be sequentially rational, which means that the Nash equilibrium at each stage of the game must rationally anticipate its subsequent equilibrium path.

The assumption of sincere voting and the citizen-candidate structure imply that each individual will simply vote for a candidate from his own social group. This fact and the proportionality of the electoral law imply that group  $j$  elects a total of  $\rho m^j$  representatives.<sup>13</sup> That is, the parliament is a mirror-image of society in the sense that the distribution of seats across the three groups exactly reflects the distribution of the population across these groups.

The agenda setter at round 1 is a representative of the middle class, which (being the largest class) has the largest number of seats in the parliament. Moreover, if the middle class fails to form a government, the second agenda setter is appointed randomly by nature and chosen between the representatives of the poor and the rich. By

<sup>13</sup> It is straightforward to verify that the supply of candidates from each group is not lower than  $\rho m^j$ . Since the parliament is large, the policy outcome does not depend on whether any individual does or does not run for office. Therefore, a citizen-candidate of group  $j$  runs for office if and only if  $pk \geq \varepsilon$ , where  $p$  is the probability of being elected, pinned down at  $p = \varepsilon/k \in (0,1]$  by the assumption of free entry of candidates.



assumption, the probability that a poor (rich) representative will be the agenda setter at the second round (conditional of the game reaching it) is equal to the share of the seats of the poor (rich) of the combined number of seats of the poor and of the rich. Hence,

$$\phi = \frac{m^p}{m^p + m^r}$$

is the probability that a poor is appointed as agenda setter at round 2.

It is clear that  $\phi$  can be interpreted as an index of the bargaining power of the poor: the higher is the number of the poor  $m^p$ , the higher is  $\phi$ , the higher is the probability that the poor are the agenda setter at the second round, the higher is their expected utility at that stage of the game and, therefore, the higher will be the public good that the middle class agenda setter (at round 1) provides them for any given level of taxation so to accept her government coalition proposal. Moreover, as we will show later,  $\phi$  is also a measure of income inequality: other things equal, a higher  $\phi$  corresponds to a more unequal income distribution.<sup>14</sup>

The legislative bargaining game has a unique (subgame-perfect) Nash equilibrium. The first agenda setter (from the middle class) formulates a coalition formation proposal based on a fiscal policy programme to another group only, given that no more than that is needed to reach a parliamentary majority. The coalition formation offer leaves the group receiving it indifferent between accepting and rejecting it and the offer is accepted. Therefore, the question we need to answer is: which group (among the poor and the rich) is the cheapest to buy? To answer this question, we first solve our bargaining game by backward induction starting from the second round.

We denote the group of the agenda setter with  $h$ , the other group part of the government with  $l$  and the stage of the game with  $s$ . Therefore,  $\tau_{s,h,l}$  is the tax rate proposed to group  $l$  by the agenda setter  $h$  at round  $s$  of the game. The correspondent level of public good received by the group  $i$  will be  $g_{s,h,l}^i$ . Similarly, the level of utility of the group  $i$  is  $w_{s,h,l}^i$ .

### 3.1.1. Round 2 of the bargaining game

**LEMMA 1.** *At round 2 of the bargaining game, the poor are always part of the government coalition; the middle class is so only if the agenda setter is a poor and the rich only if the agenda setter is a rich.*

*Proof.* At round 2, the outside option of each group is its *status quo* utility, i.e. its gross income. Since the agenda setter optimises giving to the coalition partner what is strictly necessary to induce it to accept the policy proposed, the policy menu  $(\tau_{2,h,l}, g_{2,h,l}^l)$  offered from the agenda setter  $h$  to group  $l$  satisfies the condition  $(1 - \tau_{2,h,l})y^l + H(g_{2,h,l}^l) = y^l$ . Consider the schedule  $g_{2,h,l}^l \equiv g_{2,h,l}^l(\tau_{2,h,l}; y^l)$  defined implicitly by this equation. Holding constant  $\tau_{2,h,l}$  this schedule is such that  $\partial g_{2,h,l}^l / \partial y^l = \tau_{2,h,l} / H_g(g_{2,h,l}^l) > 0$ . This means that the richer a group is, the more it has to be compensated in terms of public good provision for any level of taxation. Thus, if the rich representative is appointed

<sup>14</sup> Finally notice that the probability  $\phi \in (0,1)$  because  $m^p$  and  $m^r$  are always positive. However, in the analysis presented below we also consider the limit cases where  $\phi = 0$  and  $\phi = 1$  because they allow us to define the tax rates and utilities in the closed interval  $[0,1]$ .

agenda setter at the second round, he will always prefer the poor to the middle class as coalition partner. Alternatively, if the second round agenda setter is poor, the middle class will be cheaper to buy than the rich. The legislative bargaining protocol implies that the middle class is never the agenda setter at round 2.

Therefore, if at round 2 the agenda setter is rich, then by Lemma 1 the poor will be the coalition partner. The substitution of the equilibrium government budget constraint  $(\tau_{2,r,p}\bar{y} = g_{2,r,p}^p + g_{2,r,p}^r)$  in the utility function of the rich implies that their maximisation problem is

$$\max_{\{\tau_{2,r,p}\}} w_{2,r,p}^r = (1 - \tau_{2,r,p})y^r + H(\tau_{2,r,p}\bar{y} - g_{2,r,p}^p) \quad (3)$$

subject to the participation constraint of the poor  $(1 - \tau_{2,r,p})y^p + H(g_{2,r,p}^p) = y^p$ . If at round 2 the agenda setter is poor, he makes a coalition with the middle class and the maximisation problem is derived in a similar way.

### 3.1.2. Round 1 of the bargaining game

While the poor are always part of the government coalition if the game reaches round 2 (an off-equilibrium event), this does not need be the case at round 1. At this stage of the game, the middle class agenda setter will form the government coalition with the group that allows her to reach the highest level of utility from the implemented policy. This policy will be such to leave the group receiving the offer just indifferent between accepting it and going to the second round. As we will see, the expected utility of each group at round 2 depends positively on its probability of being agenda setter at that stage. Hence, the higher is the probability  $\phi$  of the poor of being agenda setter at round 2, the higher is their expected utility at this stage of the game, the more costly it is for the middle class to buy their vote at round 1 and, therefore, the less likely that they are part of the government coalition. In what follows, we establish a global result which identifies the winning coalition in terms of a critical value of  $\phi$ . To proceed in this direction, we first define the maximisation problems of the middle class under the two possible coalitions.

If the government coalition is made up by the middle class and the rich, the participation constraint of the rich at round 1 is

$$(1 - \tau_{1,b,r})y^r + H(g_{1,b,r}^r) \geq (1 - \phi)[(1 - \tau_{2,r,p})y^r + H(g_{2,r,p}^r)] + \phi(1 - \tau_{2,p,b})y^r. \quad (4)$$

The left hand side of (4) represents the utility of the rich if the middle class's policy proposal at round 1 is implemented, while the right hand side is their expected utility conditional on the game reaching round 2.

Substituting the equilibrium government budget constraint  $(\tau_{1,b,r}\bar{y} = g_{1,b,r}^b + g_{1,b,r}^r)$  in the utility function of the middle class, their maximisation problem becomes

$$\max_{\{\tau_{1,b,r}\}} w_{1,b,r}^b = (1 - \tau_{1,b,r})y^b + H(\tau_{1,b,r}\bar{y} - g_{1,b,r}^r) \quad (5)$$

subject to the participation constraint of the rich (4). This constraint may not be always binding however. This is the case when the dictatorial policy of the middle class gives to

the rich a higher utility than their expected utility at round 2. In this situation the consensual democracy equilibrium is equivalent to the dictatorship of the middle class which obtains the maximum level of utility by implementing her unconstrained preferred policy.<sup>15</sup> When the participation constraint of the rich is binding, the first order condition relative to the maximisation problem (5) is

$$y^b = H_g(\tau_{1,b,r}\bar{y} - g_{1,b,r}^r) \left[ \bar{y} - \frac{y^r}{H_g(g_{1,b,r}^r)} \right] \tag{6}$$

and this equation allows us to get  $\tau_{1,b,r}$  and  $g_{1,b,r}^r$  if combined with (4). Then,  $g_{1,b,r}^b$  is obtained from the government budget constraint.

If the coalition government is made up by the middle class and the poor, the participation constraint of the poor at round 1 is

$$(1 - \tau_{1,b,p})y^p + H(g_{1,b,p}^p) \geq (1 - \phi)y^p + \phi[(1 - \tau_{2,p,b})y^p + H(g_{2,p,b}^p)]. \tag{7}$$

The left hand side of (7) is the utility of the poor at round 1 if the middle class's policy proposal is implemented, while the right hand side corresponds to their expected utility if the game reaches the second round. This participation constraint is always binding (if  $y^p > 0$ ), and therefore hold with the equality sign, because the expected utility of the poor at round 2 is at least equal to their level of income (i.e. what they get if the *status quo* policy is implemented) given that they are always part of the government coalition at this stage.

The substitution of the equilibrium government budget constraint ( $\tau_{1,b,p}\bar{y} = g_{1,b,p}^b + g_{1,b,p}^p$ ) in the utility function of the middle class implies that their maximisation problem can be written as

$$\max_{\{\tau_{1,b,p}\}} w_{1,b,p}^b = (1 - \tau_{1,b,p})y^b + H(\tau_{1,b,p}\bar{y} - g_{1,b,p}^p) \tag{8}$$

subject to the participation constraint of the poor (7). The first order condition of this problem reads

$$y^b = H_g(\tau_{1,b,p}\bar{y} - g_{1,b,p}^p) \left[ \bar{y} - \frac{y^p}{H_g(g_{1,b,p}^p)} \right]. \tag{9}$$

From (9) and (7) we obtain  $\tau_{1,b,p}$  and  $g_{1,b,p}^p$ , while  $g_{1,b,p}^b$  is derived from the government budget constraint.

The next Proposition characterises the outcome of the coalition formation process at the first round of the legislative bargaining game.

<sup>15</sup> From an inspection of (4), it is immediate to verify that this is always the case whenever, as  $\phi$  approaches one, the middle class dictatorial tax rate  $\tau^b$  is lower than  $\tau_{2,p,b}$ . For example, it is easy to prove analytically that  $\tau^b < \tau_{2,p,b}$  at  $\phi = 1$  if  $y^p = 0$ . Indeed, under these conditions  $\tau_{2,p,b}$  is defined by the equation  $y^b/H_g(\tau_{2,p,b}y^b) = \bar{y}$  and the dictatorial tax rate of the middle class by  $y^b/H_g(\tau^b\bar{y}) = \bar{y}$ , which imply that  $\tau_{2,p,b}y^b = \tau^b\bar{y}$ . From  $y^b < \bar{y}$  follows that  $\tau^b < \tau_{2,p,b}$ . Our numerical simulations, that we discuss in the next Section, show that this result also holds for values of  $\phi$  different from one or when the income of the poor is positive. Clearly, the lower is the income of the poor and the higher is  $\tau_{2,p,b}$  which in turn makes more likely that the participation constraint of the rich is not binding.

PROPOSITION 2. *There exists a threshold value of  $\phi$ ,  $\phi^* \in (0,1)$  such that*

- (i) *if  $\phi < \phi^*$ , the government coalition is made by the middle class and by the poor;*
- (ii) *if  $\phi > \phi^*$ , the government coalition is made by the middle class and by the rich.*

*Proof.* See Appendix.

The intuition for this result is straightforward. When  $\phi$  is relatively low ( $\phi < \phi^*$ ), the probability that the poor are the agenda setter at round 2 is also low and so is their expected utility at the second round. This means that their vote is relatively cheap to buy at round 1. On the other hand, when  $\phi$  is relatively small,  $1 - \phi$  is relatively high, and so is the probability of the rich being the agenda setter at round 2, which in turn implies that their expected utility at the second round is high and their vote is costly to buy at round 1. Therefore, there exists a level of  $\phi$  sufficiently small that the middle class prefers to make a government coalition with the poor because their vote is cheaper to buy (than that of the rich). Clearly, the opposite is true when  $\phi$  is relatively high ( $\phi > \phi^*$ ). At the threshold  $\phi^*$ , the middle class is just indifferent between forming a coalition with the rich or with the poor.<sup>16</sup>

Two issues are worth mentioning. The first is that the sincere voting assumption is important for the result in Proposition 2, as otherwise the poor could vote for the rich when they anticipate that their representatives will not be part of the government. The second is that our result is instead independent on the *status quo* policy assumed. It is clear that changing the *status quo* may imply a variation in the government coalitions observed at round 2 with the poor not being always the cheapest to buy. However, what is key for our results is that the expected utility of poor and rich at round 2 is increasing in their probability of being the agenda setter at that stage of the game. And this is always the case because the utility of any group (poor or rich) when it is the agenda setter is higher than when it is not (independently that it belongs or not to the ruling coalition). The *status quo* may affect the absolute level of the expected utility of each class at round 2 for a given level of  $\phi$  and, therefore, the level of the threshold  $\phi^*$ . However, the middle class will prefer the poor to the rich when  $\phi$  is lower than this threshold and *vice versa*.

#### 4. The Size of Government Across Constitutions and Coalitions

While the tax rate chosen under a majoritarian constitution is only a function of the income of the rich (relative to the average one), the tax rate in a consensual democracy under the two possible coalitions is a function of the income distribution, i.e. of both the incomes of the classes ( $y^p, y^b, \bar{y}, y^r$ ) and the value of  $\phi$ . A comparison of these tax rates is not straightforward due to the strong non-linearity present in the first order conditions defining them. However, by making some assumptions on the levels of income of the classes and the utility function of the individuals we can state

<sup>16</sup> The result in Proposition 2 can be regarded as an application of the general principle by which, in coalition formation games, it can be advantageous to be in a relatively weak bargaining position as that increases the likelihood of becoming a member of the coalition. This is the opposite of what happens in a Nash bargaining process where a lower bargaining power only reduces the share of the surplus of which one can appropriate.

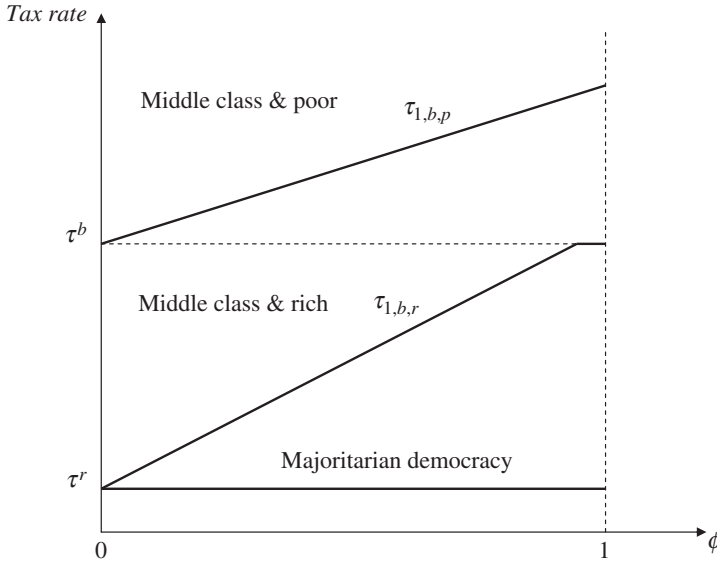


Fig. 1. Taxation Across Constitutions and Coalitions when  $y^p = 0$  and  $y^r$  is High Relative to  $\bar{y}$

the results presented and discussed below. First, we assume a power function specification for the utility derived from the public good:  $H(g^j) = A(g^j)^\alpha$ , with  $\alpha \in (0,1)$  and  $A > 0$ .

**RESULT 1.** *If  $y^p = 0$  and the income of the rich is sufficiently high relative to the average income, then the taxes set in equilibrium can be ordered as follows:  $\tau^r < \tau_{1,b,r} < \tau_{1,b,p}$ .*<sup>17</sup>

*Proof.* See Appendix.

Without the above assumptions it is not possible to derive further analytical results and, therefore, we have run several numerical simulations. The simulations show that the two assumptions on the income of the poor and the rich, which guarantee that Result 1 holds and can be proved analytically, are not necessary. Nevertheless, these assumptions provide an insight into the characteristics of the income distribution that lead to that result. In particular, the result that  $\tau^r < \tau_{1,b,r} < \tau_{1,b,p}$  for all  $\phi$  is easy to obtain when the income of the poor  $y^p$  and the income of the rich  $y^r$  are respectively low and high with respect to the average income  $\bar{y}$  or, in other words, when there is enough dispersion in the income of the three classes.

From the numerical analysis we have obtained two interesting results. First, a level of  $y^r$  sufficiently high relative to  $\bar{y}$  is enough to obtain the taxation ranking of Result 1 ( $\tau^r < \tau_{1,b,r} < \tau_{1,b,p}$ ) even when  $y^p$  and  $y^b$  are both very close to  $\bar{y}$ . Second, with an extremely equal income distribution, taxation in majoritarian democracy is always higher than taxation in consensual democracy (regardless of the ruling coalition). These results can be illustrated using two parameterisations for the income of the three

<sup>17</sup> A graphical representation of the tax rates is provided in Figure 1.

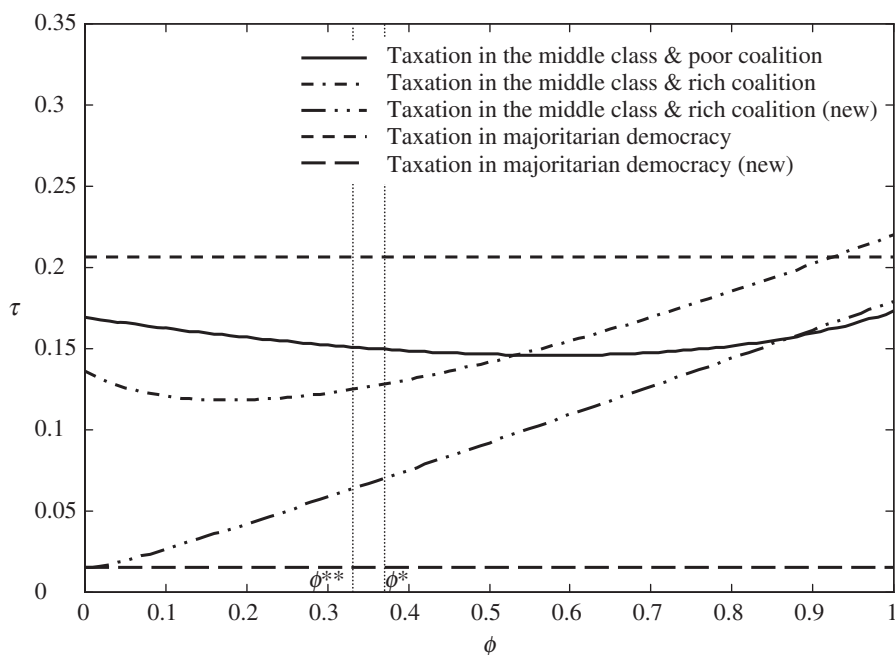


Fig. 2. Taxation with  $y^p = 0.9$ ,  $y^b = 0.95$ ,  $\bar{y} = 1$ ,  $y^r = 1.1$

Note: The Schedules with (new) and  $\phi^{**}$  refer to  $y^r = 4$ .

classes.<sup>18</sup> The first is:  $y^p = 0.9$ ,  $y^b = 0.95$ ,  $\bar{y} = 1$ ,  $y^r = 1.1$ . In the second one we just change the income of the rich and use  $y^r = 4$ . The first parameterisation corresponds to a very equal society given that the income of the poor is only 10% lower than the average income while the income of the rich is only 10% higher than the mean.<sup>19</sup> Figure 2 shows the tax rates obtained with these two parameterisations. In this case the tax rate set in consensual democracy is lower than the tax rate set in majoritarian democracy. The increase in the income of the rich from 1.1 to 4 leads to a reduction in the tax rate set in majoritarian democracy higher than the reduction in the tax rate of the middle class and rich coalition up to the point that the ranking of tax rates of Result 1 generally holds.<sup>20</sup> The explanation for this result is the following.

The fiscal policy of a single group government should involve, other things equal (i.e. if all groups have a similar income as it is in the first parameterisation), a higher tax rate and total expenditure than the policy of a two groups government coalition regardless of how the tax revenues are divided among the public goods provided. Indeed, recall that a public good is provided only if the group which likes it is part of the government coalition and the optimal tax rate of a group is such that the marginal cost of taxation equals the marginal benefit from the public good provision. While the marginal cost of taxation is independent of the number of public goods that are

<sup>18</sup> In the numerical simulations we have used the power function specification for  $H(\cdot)$  with  $A = 1$  and  $\alpha = 0.5$ .

<sup>19</sup> In this case the variation in the size of the classes and, therefore, of  $\phi$  cannot change the fact that the distribution is very equal even when there are many poor ( $\phi$  high).

<sup>20</sup> Notice that the tax rate of the middle class and poor coalition is not affected by the income of the rich.



financed with the tax revenues (i.e. the number of groups in the government coalition), the marginal benefit from that increase in taxation decreases with the number of public goods among which this increase in taxation is split. This implies that the tax rate should decrease with the number of groups in the government coalition, which in turn implies that, other things equal, the tax rate in majoritarian democracy should be higher than tax rate in consensual democracy.

However, we now need to explain why Result 1 and most numerical simulations lead to the opposite result, namely that generally the tax rate in consensual democracy is higher than the tax rate in majoritarian democracy. This result is due to the fact that in majoritarian democracy fiscal policy is decided by the group with the highest level of income (the rich), while in consensual democracy fiscal policy is chosen by a government coalition representing two groups with an average level of income lower than the income of the rich. Similarly, the middle class and poor coalition taxes and spends more than the middle class and rich one exactly because it contains a group (the poor) with lower income. If the incomes of the three classes are sufficiently spread, then the latter effect more than compensates the effect (described above) generated by the number of groups in the government leading to the taxation ranking of Result 1 ( $\tau^r < \tau_{1,b,r} < \tau_{1,b,p}$ ).

There are also other features of the relationship between the tax rates across constitutions for different income distributions that deserve to be analysed more deeply. Our numerical simulations have shown that taxation in majoritarian democracy is lower than taxation under the middle class and poor coalition even if the dispersion in the income levels of the three classes is very small.<sup>21</sup> A slightly higher spread in this distribution is necessary if we want the tax rate of the middle class and rich coalition to be higher than the tax rate in majoritarian democracy for all  $\phi > \phi^*$ . As it will be made clear in the next Section, we are interested in the case where  $\tau^r < \tau_{1,b,r}$  when  $\phi > \phi^*$  and the numerical simulations suggest that this result holds if there is a minimum degree of dispersion in the income levels of the three groups. Indeed, using the previous parameterisation ( $y^p = 0.9$ ,  $y^b = 0.95$ ,  $\bar{y} = 1$ ) and increasing the income of the rich to 1.6 is enough to have  $\tau^r < \tau_{1,b,r}$  for all  $\phi > \phi^*$  and a further increase in  $y^r$  implies that  $\tau^r < \tau_{1,b,r}$  also for most values of  $\phi < \phi^*$ .<sup>22</sup> The result of the numerical simulation with such parameters is reported in Figure 3, while Figure 4 presents an example with a different parameterisation.<sup>23</sup>

## 5. Income Inequality and Constitutional Choice

Having characterised the political equilibrium of the model under the two possible institutional arrangements, we now turn to the question of which of them would be chosen *ex ante* by society, when the constitution is endogenous. We assume that the

<sup>21</sup> For example, with the above parameterisation ( $y^p = 0.9$ ,  $y^b = 0.95$ ,  $\bar{y} = 1$ ) an income level of the rich higher than 1.3 is enough to obtain  $\tau^r < \tau_{1,b,p}$  for all  $\phi \in (0,1)$ .

<sup>22</sup> Moreover, notice that an increase in the income of the rich always leads to a reduction in  $\phi^*$ .

<sup>23</sup> The results presented above are robust to all parameterisations we have used. Additional numerical simulations are available from the authors. It is also worth noting that all simulations confirms that the utility of the middle class in the government coalition with the rich  $w_{1,b,r}^b$  is monotonically increasing in  $\phi$ , while the utility of the middle class in the coalition with the poor  $w_{1,b,p}^b$  is strictly monotonically decreasing in  $\phi$ , so that  $\phi^*$  is unique.

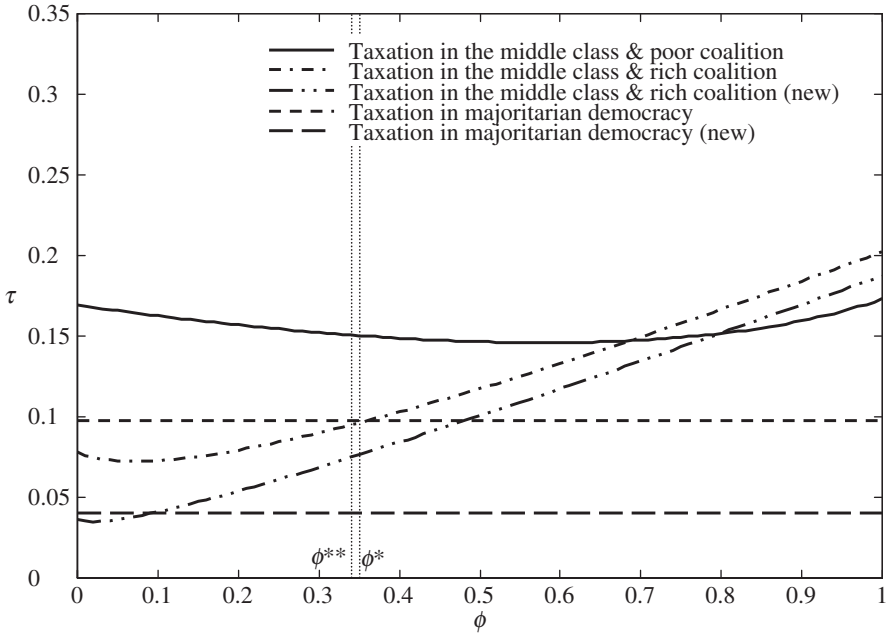


Fig. 3. Taxation with  $y^p = 0.9$ ,  $y^b = 0.95$ ,  $\bar{y} = 1$ ,  $y^r = 1.6$   
 Note: The Schedules with (new) and  $\phi^{**}$  refer to  $y^r = 2.5$ .

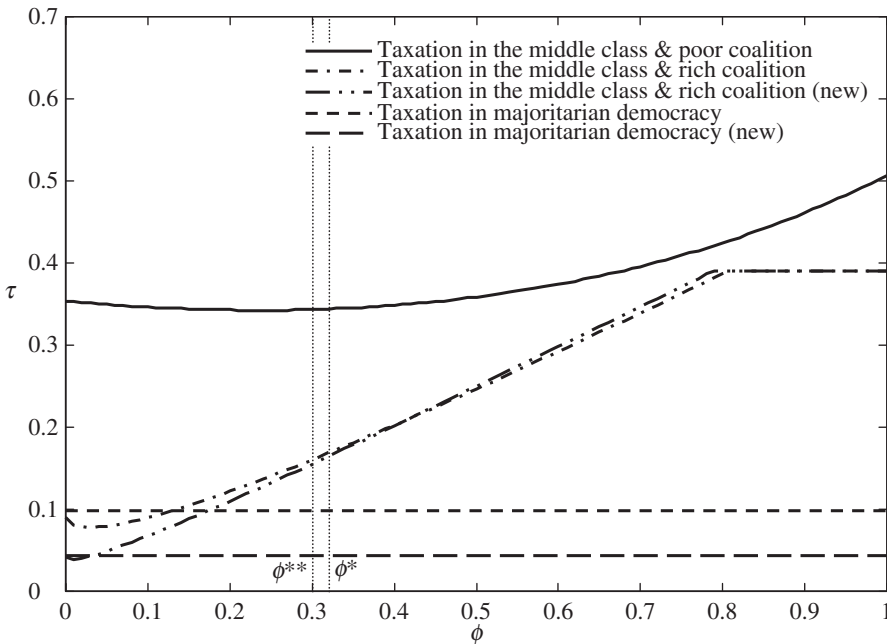


Fig. 4. Taxation with  $y^p = 0.3$ ,  $y^b = 0.8$ ,  $\bar{y} = 1$ ,  $y^r = 1.6$   
 Note: The Schedules with (new) and  $\phi^{**}$  refer to  $y^r = 2.4$ .

process of constitutional choice takes place in an original position where individuals know their class-status and preferences and before any other politico-economic interaction. We also assume that the decision is taken by simple majority voting and that the available alternatives are the two constitutional regimes we have considered. Given that there is no veil of ignorance and uncertainty, individuals correctly anticipate what their level of utility would be under the two possible constitutions and vote consequentially. Finally, we assume that there is a minimum degree of dispersion in the income levels of the three groups so that the tax rates ranking of Result 1 holds, or at least that the tax rate set under the middle class and rich coalition is higher than the tax rate under majoritarian democracy when  $\phi > \phi^*$ .

**PROPOSITION 3.** *If  $\phi < \phi^*$ , society chooses consensual democracy while it prefers majoritarian democracy when  $\phi > \phi^*$ .*

*Proof.* It is clear that for the rich and the middle class the constitutional choice has a trivial, albeit opposite, solution. Since majoritarian democracy expresses the dictatorship of the rich, they will prefer it unconditionally. Similarly, given that the middle class has the relative majority of votes, which allows it to have the first agenda setter in the legislative bargaining game, she will prefer the consensual constitution unconditionally.<sup>24</sup> The most interesting decision is the one of the poor, who turn out to be the swing voters. The poor do gain from the higher political inclusion which is typical of consensual democracy, only if they are part of the government coalition as partner of the middle class agenda setter. In this case they are clearly better off than they are in a majoritarian setting.<sup>25</sup> However, we know that this need not always be the case, since the ruling coalition does not include them whenever  $\phi \in (\phi^*, 1)$ . In this instance the poor are actually worse-off in a consensual democracy: they do pay higher taxes (see the discussion in the previous Section) but also get no provision at all of their specific public good. Therefore, if  $\phi \in (0, \phi^*)$  the majority prefers consensual democracy while majoritarian democracy is chosen when  $\phi \in (\phi^*, 1)$ .

We now present two mean preserving spreads of the distribution of income which show that an increase in income inequality makes the adoption of a majoritarian democracy more likely.

*Mean Preserving Spread 1.* We first consider a transformation of the income distribution that affects the size of the three classes. We suppose that  $m^b$  and  $m^r$  increase and that  $m^b$  decreases in such a way that both the size of the population and the average level of income  $\bar{y}$  remain constant. Then, society has a smaller middle class, more rich and more poor; that is, it is more unequal.

We now show that, whilst the threshold  $\phi^*$  is not affected by this transformation, the value of  $\phi$  necessarily increases. Therefore, it becomes more likely that  $\phi$  belongs to the

<sup>24</sup> It is trivial to deduce that the middle class is always better off in a consensual democracy than in a majoritarian one. Indeed, notice that in consensual democracy the middle class would always have the option of replicating the majoritarian outcome by offering to the rich of forming a coalition and implementing their own preferred policy.

<sup>25</sup> If the poor are part of the government coalition they get a utility at least as high as their income level, while in majoritarian democracy they always get a lower level of utility because of positive taxation and no provision of their public good.

interval  $(\phi^*, 1)$  and that a majoritarian democracy is chosen. To this end, let us consider the definition of the average income,  $\bar{y} = m^p y^p + m^b y^b + m^r y^r$ , and divide both sides by  $(1 - m^b) = (m^p + m^r)$  taking into account that  $\phi = m^p / (m^p + m^r)$ . Then, rearranging terms we get

$$y^r - \phi(y^r - y^p) = \bar{y} + \frac{m^b}{1 - m^b}(\bar{y} - y^b). \quad (10)$$

A decrease in  $m^b$  implies a reduction in the right hand side of (10) as  $\bar{y} > y^b$ . Therefore,  $\phi$  must increase given that  $y^r > y^p$ . This means that  $\phi$  can also be interpreted as a measure of income inequality. Again, our model predicts that when income inequality is relatively low ( $\phi < \phi^*$ ) society prefers a consensual democracy, while it chooses a majoritarian system when income inequality is relatively high ( $\phi > \phi^*$ ).

*Mean Preserving Spread 2.* Another mean preserving spread we consider is generated by a transformation of both the size of the classes and the income of the rich. In particular, we analyse the effect on constitutional choice of an increase in inequality caused by the increase in the income of the rich, accompanied by an equi-proportional increase in the number of the rich and of the poor (and a reduction of the middle class) so that both  $\phi$  and  $\bar{y}$  are unaffected.<sup>26</sup>

Given that  $\phi$  remains constant, we need to determine how  $\phi^*$  changes to understand which constitution is more likely to be chosen by the society. To this end, we need to find out how the two schedules representing the utility of the middle class under the two possible coalitions vary as  $y^r$  increases. First, observe that the utility of the middle class in the coalition with the poor  $w_{1,b,p}^b$  does not depend on the income of the rich  $y^r$  and therefore it is not affected by any variation of it. The utility of the middle class in the government coalition with rich  $w_{1,b,r}^b$  is instead a function of  $y^r$ . We are not able to show analytically how this schedule changes with the income of the rich but the numerical simulations we discussed in the previous Section point out that it shifts upward (i.e.  $w_{1,b,r}^b$  increases) as  $y^r$  goes up leading to a reduction in  $\phi^*$ .<sup>27</sup> This means that this increase in income inequality leads to a reduction of the range  $(0, \phi^*)$  where consensual democracy is chosen and, therefore, it makes more likely the adoption of a majoritarian constitution.

Finally, it is worth emphasising that, although the model is purely static, it contains forces that would make it dynamically stable. If income inequality is relatively high, society should choose a majoritarian constitution. The fiscal policy in this constitutional system should favour the rich and therefore not reduce (or even increase) the initial degree of inequality. Then, society should continue to prefer a majoritarian constitution. Conversely, if income inequality is relatively low, society will prefer a consensual democracy under which fiscal policy generally reflects the preferences of middle class and poor. This should lead to the provision of public goods that reduce or maintain the initial level of inequality and, therefore, a majority for a consensual constitution.

<sup>26</sup> According to our theory, this particular mean preserving spread corresponds to the shocks driving the cases of constitutional change in France, Germany and Italy that we discuss next.

<sup>27</sup> More precisely, for certain parameterisations it is possible to observe that  $w_{1,b,r}^b$  shifts upward for almost all  $\phi$  except for values close to one where it shifts down. However, this is always irrelevant because it happens for values of  $\phi$  very far from  $\phi^*$ .

## 6. Some Evidence on Class Politics and Constitutional Choice

The theory presented in this article has many interesting predictions. The main result is that income inequality has an important effect on the choice of the constitution. While a test of this prediction is reported in the next Section, we here discuss other results of our theory that are worth emphasising in relation to the available evidence.

A first prediction of our theory is that consensual democracies should have bigger governments than majoritarian ones and a larger part of government expenditure should go to the advantage of a greater number of social groups and, in particular, to lower income individuals (the poor and the middle class). As emphasised in the Introduction, these results are in line with the existing theoretical literature (Persson and Tabellini, 2000; Lizzeri and Persico, 2001) and with the empirical results of Persson and Tabellini (2003, 2004), Milesi-Ferretti *et al.* (2002) and Lijphart (1999).

The novelty of our theory is in the specific mechanism leading to this result. It is usually argued that public expenditure is higher under proportional electoral systems than under majoritarian ones because the former favours the representation of many groups and the formation of multi-party coalition governments, which in turn spend more because they need to please broader and more diverse constituencies than single-party executives. Instead, in our model, the same prediction is due to a *selection bias* in the composition of the government coalition as consensual democracies should be expected to be ruled relatively more often by centre-left coalitions, while the fiscally conservative right should have an advantage in majoritarian constitutions. While we do not pursue an empirical analysis on this point here (although interesting, this is not the key finding of our article), it is worth noting that such a result is consistent with the existent empirical evidence about the effects of the government's ideology on fiscal policy outcomes suggesting that left-wing executives are willing to tax and spend more than right-wing ones; see on this Alesina *et al.* (1997) and the references cited therein, as well as Perotti and Kontopoulos (2002). Our mechanism is also in accordance with the findings of Powell (2002) which, in a sample of 17 advanced democracies for the period 1978–94, show that 58% of the governments in PR systems were leftist, while this fraction was only 37% in majoritarian democracies. A similar result can be obtained using an index of partisanship of the government on the left–right dimension compiled by Cusack (1997). The index ranges from 1 (extreme left) to 4 (extreme right) and it is provided for 16 OECD countries for the periods 1950–9, 1960–9, 1970–9, 1980–91.<sup>28</sup> Over the whole period 1950–91, the average value of the Cusack index is 3.49 in majoritarian democracies (Australia, Canada, UK, US and France) and 2.92 in consensual democracies (Austria, Belgium, Denmark, Finland, Germany, Italy, Norway, the Netherlands, Sweden, Switzerland and Japan) and this difference is statistically significant at 5% level.<sup>29</sup> These results corroborate the prediction of our model according to which consensual democracies should be ruled

<sup>28</sup> The index is based on the computation of the ‘political centre of gravity’ of a government, defined as the average ideological collocation of the parties of the coalition on the left–right continuum, weighted by the share of seats of each of them; see Cusack (1997, Table 1 and pp. 381–2) for more details.

<sup>29</sup> The results do not change if we consider the subperiods, where it is also possible to observe that the variability of this index over time is rather small. For consensual democracies the index gets the following average values: 2.95 in 1950–9, 2.91 in 1960–9, 2.76 in 1970–9 and 3.06 in 1980–91. The average values for majoritarian democracies are: 3.72 in 1950–9, 3.46 in 1960–9, 3.41 in 1970–9 and 3.39 in 1980–91.

relatively more often by centre-left governments whereas majoritarian democracy should advantage conservative parties.<sup>30</sup>

Our model has the prediction that the poor may vote for the rich in the majoritarian systems. This finding is in accordance with previous results obtained in models of public provision of private goods (Epple and Romano, 1996) where 'extreme coalitions' (i.e. coalitions made up by the rich and the poor) emerge in equilibrium and offer a rational explanation for the 'Reagan Democrat' phenomenon (Greenberg, 1996), namely for the working-class voter supporting low tax and socially conservative policies.<sup>31</sup>

The results of our model can also help us to understand the relationship between the distribution of income and fiscal policy outcomes better. The standard result of the political economy models based on the theory of the median voter (Meltzer and Richard, 1981) is that higher (pre-tax) inequality should be expected to generate political support for a larger fiscal redistribution of resources. This theory, however, does not seem to be corroborated by the data (Perotti, 1996; Bénabou, 2000) which, if anything, indicate that more equal societies tend to redistribute more rather than less. Our theory suggests that the absence of a negative relationship between inequality and redistribution may be due to the fact that more unequal societies are more likely to choose a majoritarian system, which in turn generates lower redistribution.<sup>32</sup> Moreover, income inequality may also have ambiguous effects for a given constitution. In a consensual democracy, an increase in inequality generally leads to an increase in taxation and redistribution for a given government coalition but has the opposite effect if it leads to the formation of a centre-right majority instead than a centre-left one. In a majoritarian democracy, more inequality affects taxation and redistribution only if it is associated to a variation in the income of the rich.

Another prediction of our model concerns the preferences of the social classes for the constitution. The rich should prefer the majoritarian democracy, the middle class the consensual one, while the attitude of the poor should depend on the level of income inequality. They are supposed to prefer the consensual system for low levels of inequality and *vice versa*. Identifying the preferences of the various social classes for the type of constitution is not an easy task and it goes beyond the scope of this article to provide a deep analysis on this point. However, we now present some historical examples of constitutional choice that appear to be in accordance with our theory. In particular, we first discuss three cases (US, UK and Chile) of choice of majoritarian constitutions that support the idea that the rich prefer this political system. Then, we analyse the adoption of consensual constitutions in continental European countries in the first half of the twentieth century and argue that this choice was generally influenced by centre-left forces in a period of low and/or declining income inequality.

<sup>30</sup> Our results also provide a theoretical ground to the finding of Scheve and Stasavage (2007) that, in a sample of 13 countries for the period 1976–2000, government of the right (left) is associated with more (less) income inequality.

<sup>31</sup> We thank an anonymous referee for pointing this to our attention.

<sup>32</sup> Our model of endogenous selection of the constitution may also help explaining why some recent studies, such as Scheve and Stasavage (2007), do not find an effect of PR on the reduction of income inequality. Most equal societies or those that tend more rapidly towards equalisation are likeliest to have adopted and retained PR.



The US has the oldest written constitution of the world, dating from 1787. It was drafted by a Constitutional Convention of delegates from all States (with the exception of Rhode Island). Apart from some relatively minor changes, it has remained essentially the same up today. An economic analysis of the American constitution has been provided by Beard (1913), which shares with ours the basic premise that key constitutional principles ought to be interpreted as reflecting the interests of particular social groups or classes as opposed to the 'public good'. In particular, Beard points out that the economic interests of the members of the Convention essentially corresponded only to those of the rich (the commercial and financial elite as well as of the landlords), who were concerned to secure individual property rights and guarantee the best possible institutional framework for private economic activity. Correspondingly, the middle and the lower classes had very little if any voice at all in the Convention, due to both the strong franchise restriction of the time and the 'class-consciousness' of many of the less well-off among the enfranchised. Beard also demonstrates the extraordinary awareness of the economic elite and of its political and intellectual leadership, about the nature of its interests in the process of constitution making.<sup>33</sup> Remarkably, in the tenth number of *The Federalist*, Madison argues that: 'The first object of government is the protection of the diversity in the faculties of men, from which the rights of property originate', and that this requires the creation of an institutional framework to prevent the exploitation of the rich by the lower classes.

England has the oldest unwritten constitution of the world. It consists in a collection of different documents including the *Magna Carta* of 1215, the *Bill of Rights* of 1689, commonly observed practices and conceptions, as well as some laws. Despite experiencing significant transformations over time, including a gradual extension of franchise since the first decades of the nineteenth century (1832, 1867 and 1884), the constitution always remained majoritarian. The making of the English constitution, like that one of the US, occurred over a period of time during which the political voice of the upper classes was overwhelming and is another example of the preference of the rich for the majoritarian model.

The rich have occasionally been able to impose their constitutional preferences even in much more recent times and, as suggested by our theory, they have opted for the majoritarian model. A notable example is the majoritarian constitution of Chile implemented under the leadership of General Pinochet, who arguably represented the political and economic interests of the elites. A politico-economic analysis of this constitution has been offered by Baldez and Carey (1999), who assert (p. 52) that: 'The Chilean military regime consciously crafted the 1980 Constitution, the budget process, and the electoral system in order to constrain the policy outcomes generated by elected civilian politicians. To a certain extent, the institutional engineers appear to have succeeded – particularly in designing an electoral system that has disproportionately rewarded the right and a budget process that generally encourages fiscal austerity.'

The model of consensual democracy has been adopted extensively in continental Europe in the first half of the twentieth century. Our theory predicts that this should have

<sup>33</sup> This also confirms that our assumption on the absence of a veil of ignorance in choosing the constitution is appropriate.

been the choice of the centre and leftist parties in the presence of low income inequality. Both conditions are not easy to identify precisely for many countries but, as we now show, the available historical evidence is broadly consistent with this result of our theory.

Proportional electoral systems have been first introduced in Nordic countries (Denmark, Norway, Sweden and Finland) and elsewhere in Northern Europe (the Netherlands) between the nineteenth and the early twentieth century. By 1921, all Nordic countries had adopted some form of proportional representation (PR) none of which has been discarded afterwards, even for a short period; see for instance Lakeman and Lambert (1955). Other European countries, such as France, Germany and Italy, adopted PR in 1919, after World War I. This system was abandoned at some point during the interwar period and then reintroduced immediately after World War II.<sup>34</sup>

The first question to address is whether inequality was low in the above cited countries. Although the available data on income inequality are limited and not very precise, it can be argued this seems to have been the case. Piketty (2007) (see also the references therein) documents the occurrence in France of a sharp fall in inequality associated to a sensible drop in the top percentile income share during the period 1914–45.<sup>35</sup> This trend has been driven primarily by the shocks represented by the two World Wars (especially the second one) and by the events of the interwar period (inflation and the Great Depression). As we said, in the immediate aftermath of both wars, France switched to PR. Piketty (2007) makes clear that this reduction in income inequality was not limited to France but common to many European countries, especially those that were hit by the two World Wars.<sup>36</sup> This is consistent with countries, such as Italy and Germany, switching to PR after the end of both wars.<sup>37</sup> For European countries that chose their constitution at the beginning of the twentieth century, we can obtain some data on income distribution from Morrisson (2000). He suggests that income inequality in Denmark at the time of the adoption of PR (1920) was overall relatively low.<sup>38</sup> For Norway, Morrisson (Table 2, p. 224) documents a fall in the Gini coefficient from 0.68 in 1855 to 0.34 in 1920, a low level of inequality consistent with the adoption of PR in 1921. The Netherlands adopted a proportional electoral law as early as 1917. While no precise evidence at the time of the adoption of the constitution is available, income inequality seems to have generally decreased in the Netherlands since the end of the nineteenth century.

The second question we need to answer is whether the demand of adoption of PR came from centre-left parties as our theory suggests. A discussion of this issue is

<sup>34</sup> In particular, Denmark adopted PR in 1920, Norway in 1921, Sweden in 1907, Finland in 1906, the Netherlands in 1917, France in 1919 and 1946, Germany in 1919 and 1945, Italy in 1919 and 1948. France abandoned PR after the 1924 election with the reversion to the second ballot in single-member constituencies that was used until the war. The suspension of PR in Italy and Germany followed instead the rise of fascism and nazism respectively.

<sup>35</sup> The reduction of income inequality generated by a reduction in the top percentile income share corresponds to a change in the income distribution equivalent to our mean preserving spread 2 that we have analysed in the previous Section.

<sup>36</sup> For example, the available evidence from Morrison (2000, p. 232) also confirms that income inequality in Germany strongly decreased from 1913 to 1926 and that it was low after World War II.

<sup>37</sup> Austria also adopted PR at the end of World War I.

<sup>38</sup> The data on income inequality in Denmark are based on the maximum equalisation coefficient (MEC), which indicates the share of total income which has to be transferred from the population with income above the average to those below in order to achieve an equal distribution. This index falls sharply from 0.50 to 0.35 between 1870 and 1900, and was 0.36 in 1925.

presented in Alesina and Glaeser (2004) where they argue that the diffusion of PR across Continental Europe (for the above cited countries) in the twentieth century was related to the political strength enjoyed by the left and by the workers' movement that succeeded in imposing it on the conservative forces. An exception to this pattern is represented by Sweden where the choice of a proportional electoral system in 1907 was made by the right that feared to lose representation after the extension of franchise. This case is in contradiction with our theory and in accordance with Rokkan (1970) who explains the introduction of PR in Europe as a strategic choice of the traditional nineteenth-century liberal parties to preserve part of their political power in spite of the gradual franchise extension, and of the consequent increasing importance of new mass political parties, in particular Socialist ones.

While the historical example of Sweden, and probably of other countries,<sup>39</sup> may not be in accordance with our theory, the broad picture that emerges from the above discussion is that there is some historical evidence supporting our theoretical results. The recent history on constitutional choice also provides some useful information. For example, at the beginning of the 1990s, the Eastern European countries of the former Soviet Block have made a transition to democracy. These countries had an equal income distribution at that time (see Table 2 for details) and have generally chosen a consensual constitution. On the other hand, there are also consensual democracies in Europe that have recently experienced an increase in inequality. For these countries, it is natural to ask whether PR will come in to question or be abandoned. Up until now, there have been very few changes of electoral rules in advanced democracies without any clear pattern and, therefore, to answer this question we will probably need some more time. It is important to keep in mind, however, that an increase in inequality may not be enough to produce a constitutional change, as this requires inequality increasing above a certain threshold. And this may in turn be anticipated by centre-left governments that have an interest in this not taking place.

## 7. Empirical Evidence on Inequality and Constitutional Choice

In this Section we test the main prediction of our article that more unequal countries are expected to choose a majoritarian democracy while equal societies should prefer a consensual constitution. We test this prediction by analysing the relationship between the type of constitution adopted and the income inequality of the country at the time, or before, the constitution was chosen in order to avoid problems of endogeneity.<sup>40</sup> Given that constitutional reforms are rare, a feature potentially representing an equilibrium outcome according to our model, we perform a cross-sectional analysis using the dataset compiled by Persson and Tabellini (2003, 2004) (PT from now on) to analyse the economic effects of constitutions. As a measure of income inequality, we employ the Gini index and use the dataset compiled by Deininger and Squire (1996).

PT report the variables *maj* and *pres* that define the electoral system and the form of government for 85 countries that have been selected on the base that they can be

<sup>39</sup> On the other hand, we admit that there is no unanimous consensus among political scientists about the Alesina and Glaeser's view.

<sup>40</sup> In fact, our theory predicts that income inequality determines the choice of the constitution, which in turn affects the distribution of income through its effects on fiscal policy outcomes.

classified as free or partly free democracies for the period 1990–8.<sup>41</sup> PT classify the electoral rule and the form of government within the countries at the beginning of the 1990s. We have taken this classification and identified the first year when this constitution (represented by *maj* and *pres*) was first introduced and summarised it in the variable *yearcons*. Then, we have selected a Gini coefficient for each country from the Deininger and Squire dataset according to the following rules. We have first considered the high quality data and selected the Gini coefficient correspondent to the year when the constitution was introduced, which is given by the variable *yearcons*. If there were no data in that year, we have gone backward and selected the first Gini coefficient available. When there were no data before the year of the constitution, we have taken the first Gini coefficient available after that year with the constraint that it was not more than 5 years older.<sup>42</sup> Following this procedure, we have obtained a high quality Gini coefficient for 43 countries. When we did not find a high quality Gini coefficient with this procedure, we have relied on the other (low quality) data available in this dataset following the same procedure. When more than one coefficient was available in the same year, we have taken the average. This has allowed us to obtain a Gini coefficient for a total of 57 countries.<sup>43</sup> The data from Deininger and Squire specify whether the Gini coefficient is computed using information on income or on expenditure, if the income is gross or net of taxes and if the recipient unit is an individual or a household. Deininger and Squire argue that the most important distinction is between the Gini coefficients that are based on information on income and those based on expenditure. In order to ensure intertemporal and international comparability, they strongly suggest adjusting for differences between income-based and expenditure-based coefficients by adding 6.6 points to the latter. We have therefore made this adjustment and denoted by *giniycal* the Gini coefficient with this correction.

An important point that we need to address concerns the classification of the countries into majoritarian and consensual democracies. As explained before, this classification is straightforward for parliamentary systems given that the executive is accountable to the parliament so that the electoral rule, majoritarian versus proportional, is enough to classify the type of democracy. In presidential regimes fiscal policy is the outcome of a bargaining process between the president and the legislative assembly. If the assembly is elected with plurality rule, then it is reasonable to classify

<sup>41</sup> In particular, *maj* is a dummy variable equal to 1 if all the lower house is elected under plurality rule and 0 under a proportional (or mixed) electoral system, while *pres* is a dummy variable for the form of government, equal to 1 in presidential regimes and 0 in parliamentary democracies; see PT (2003, ch. 4) for details and clarifications.

<sup>42</sup> The choice of taking a Gini coefficient that refers to few years later the constitutional choice is based on the same rationale that has led PT to exclude the reforms that some countries have made during the 1990s in their cross-sectional analysis for the period 1990–8. They argue that it takes some time before constitutional reforms have an impact on fiscal policy outcomes (see p. 88). However, if this is true (as we believe), then there will also need some time before the constitution has an impact on income inequality given that this effect should mainly work through fiscal policy.

<sup>43</sup> Cyprus and South Africa are not in the dataset although we had a Gini coefficient for these countries. Cyprus has been excluded because we had a Gini coefficient for one year only and two constitutional choices very close to that year. While the more reasonable constitution would in principle favour our hypothesis, including Cyprus with either constitutions leaves our results unchanged. Details can be supplied by the authors in the form of a data appendix. South Africa has been excluded because it is an outlier and an influential observation. A further appendix, available from the authors, also shows that the inclusion of this observation in the sample has a very large impact on the estimates.

these systems as majoritarian democracies given that both subjects that have a role in fiscal policy decisions are elected with a winner-takes-all process and are, therefore, expected to have the same fiscally conservative preferences. Instead, when the congress is elected with PR, it is important to understand the power of the president in fiscal policy decisions (see footnote 9). In our sample, the presidential systems with PR are characterised by a relative powerful president and should, therefore, be considered majoritarian democracies. This is confirmed by three considerations. First, PT classify as presidential only those regimes where the confidence of the assembly is not necessary for the executive. Second, the presidential countries with PR in our dataset are classified as 'direct presidential' in the Database of Political Institutions.<sup>44</sup> Finally, it is worth emphasising that almost all of these countries in our sample are located in Latin America and while the exact distribution of the legislative power varies across countries, according to many scholars of comparative politics the president in Latin American countries typically plays a key role in the legislative process regarding fiscal policy.<sup>45</sup>

Based on the above considerations, we have structured our empirical analysis as follows. First, we have analysed the relationship between income inequality and electoral system in the sub-sample of parliamentary democracies. This choice is justified by the fact that our model describes precisely this system and also allows us to consider a more homogenous sample. Second, we have considered the whole sample, classifying the type of democracy on the base of the electoral system only. In this case, the presidential systems with PR enter as consensual democracies. As we will see, this is the worst specification for our theory because the income distribution in these countries is generally very unequal. Finally, we develop the empirical work with the classification that we consider more reasonable and closer to our model, namely by classifying the presidential regimes with PR as majoritarian systems.

Table 1 provides descriptive statistics for income inequality in various samples. Among the parliamentary democracies, the countries with a majoritarian electoral rule are more unequal than those with PR. The difference in the average Gini coefficient is almost 10 points and it is statistically significant at the 1% level. The unconditional correlation between the Gini coefficient and a majoritarian electoral system is 0.485. We observe that the average income inequality in presidential regimes is high (the Gini index is about 49) and independent on the electoral formula of the assembly. In our view, this is consistent with the majoritarian characteristics of both systems. When we

<sup>44</sup> In this dataset, compiled by Beck *et al.* (2000), three elements are considered: (a) veto power: president can veto legislation and the parliament needs a supermajority to override the veto; (b) appoint prime minister: president can appoint and dismiss prime minister and/or other ministers; (c) dissolve parliament: president can dissolve parliament and call for new elections. The system is a 'direct presidential' if (a) is true, or if (b) and (c) are true.

<sup>45</sup> For instance, Morgenstern (2002) argues that Latin American legislatures are only 'reactive', namely they only have the ability to amend/veto legislative proposals made by the president. Such prerogatives are also limited as presidents facing a hostile legislature typically have many ways to bypass it by using their 'unilateral powers', such as various types of decrees and regulatory rule making, as well as their own veto powers on parliamentary deliberations. According to Cox and Morgenstern (2002 p. 461) '...presidents in Latin America regularly make policy decisions almost unilaterally. Presidents in Bolivia, Brazil, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay and Venezuela have tremendous advantages in structuring the budget process, as the legislatures there are constitutionally restricted from making significant changes.' As a result, according to the same authors, 'Latin American legislatures are hindered by a lack of time, resources and experience. This combination of constitutional and organisational limits has converted many Latin American presidents into virtual budget dictators.'

Table 1  
*Descriptive Statistics of Income Inequality (Variable: Giniyca)*

	Obs	Mean	Std. Dev.	Min	Max
Sample: PARLIAMENTARY DEMOCRACIES					
Majoritarian	14	43.936	8.933	25.71	57.4
Proportional	17	34.179	9.132	21.5	51
Total	31	38.585	10.17	21.5	57.4
Sample: PRESIDENTIAL DEMOCRACIES					
Majoritarian	9	48.95	12.723	28.53	68.6
Proportional	17	49.534	9.33	33.64	65.38
Total	26	49.332	10.373	28.53	68.6
Sample: WHOLE – classification: based on the electoral system					
Majoritarian	23	45.898	10.596	25.71	68.6
Consensual	34	41.856	11.974	21.5	65.38
Total	57	43.487	11.515	21.5	68.6
Sample: WHOLE – classification: presidential systems with PR enter as majoritarian					
Majoritarian	40	47.443	10.118	25.71	68.6
Consensual	17	34.179	9.132	21.5	51
Total	57	43.487	11.515	21.5	68.6

consider the whole sample and distinguish on the base of the electoral rule, we find that countries with plurality rule have higher income inequality than those with PR (significant at 10% level) but this difference is lower with respect to the sample of parliamentary democracies. The unconditional correlation between the Gini coefficient and the electoral system is positive but not very high (it is 0.174). Finally, the last part of the Table shows the statistics when presidential systems with PR are classified as majoritarian democracies. Majoritarian democracies are much more unequal than consensual ones and the difference in average inequality is about 13 points with a statistically significance at 1% level (the correlation between Gini coefficient and majoritarian democracy is also high, 0.532).

Table 2(a) reports the majoritarian and consensual countries in each quartile of the income distribution for the sample of parliamentary democracies. The first quartile contains just one majoritarian country and seven consensual ones, while we observe the opposite pattern in the last quartile of the distribution. The number of majoritarian (consensual) countries is also monotonically increasing (decreasing) in the degree of income inequality. Panel (b) shows the results of the same analysis for the whole sample when we consider the classification based on the electoral system only. As expected from the above discussion, we observe a positive relationship between the degree of income inequality and number of majoritarian democracies, though this is weaker than in the sample of parliamentary democracies. The positive link between inequality and majoritarian electoral system can be appreciated if we consider two groups, countries with inequality below and above the median. The number of majoritarian countries with income inequality higher than the median is the double of those with inequality lower than the median. Finally, Panel (c) provides the results of this analysis when presidential regimes with an assembly elected with PR are classified as majoritarian systems. The positive relationship between income inequality and majoritarian democracy is very strong as, with the exception of one country, there are no consensual democracies with



Table 2  
*Income Distribution and Constitution Selection*

<i>(a) Income distribution in parliamentary democracies</i>					
	1 <sup>st</sup> quartile $21.5 \leq \text{gini} \leq 26.98$	2 <sup>nd</sup> quartile $30.06 \leq \text{gini} \leq 40.58$	3 <sup>rd</sup> quartile $41.71 \leq \text{gini} \leq 45.49$	4 <sup>th</sup> quartile $46.02 \leq \text{gini} \leq 57.4$	Total
Majoritarian	Ukraine	Nepal, Bangladesh, Malaysia	India, Bahamas, Barbados	Trinidad & T., Japan, Singapore, France, Thailand, Jamaica, Botswana	
Consensual	Slovak R., Hungary, Romania, Bulgaria, Czech R., Poland, Latvia	Taiwan, Spain, Italy, Germany, Portugal	Greece, Estonia, Fiji, Senegal	Turkey	
Majoritarian	1	3	3	7	14
Consensual	7	5	4	1	17
Total	8	8	7	8	31
		Below the median	Above the median		
Majoritarian		4	10		14
Consensual		12	5		17
Total		16	15		31

<i>(b) Income distribution in the whole sample. Classification of majoritarian and consensual based on the electoral system</i>					
	1 <sup>st</sup> quartile $21.5 \leq \text{gini} \leq 35.45$	2 <sup>nd</sup> quartile $37.11 \leq \text{gini} \leq 43$	3 <sup>rd</sup> quartile $45 \leq \text{gini} \leq 50.11$	4 <sup>th</sup> quartile $51 \leq \text{gini} \leq 68.6$	Total
Majoritarian	Ukraine, Belarus, Nepal, Bangladesh	Pakistan, Malaysia, Ghana, India	Bahamas, Barbados, Trinidad & T., Philippines Japan, Uganda, Singapore, France, Zambia	Thailand, Jamaica, Botswana, Chile, Zimbabwe, Malawi	
Consensual	Slovak R., Hungary, Romania, Bulgaria, Czech R., Poland, Latvia, Taiwan, South Korea, Sri Lanka	Spain, Italy, Paraguay, Germany, Portugal, Uruguay, Greece, Argentina, Estonia, Fiji, Senegal	Dominican R., Venezuela, El Salvador, Bolivia, Guatemala	Turkey, Peru, Brazil, Mexico, Nicaragua, Colombia, Honduras, Ecuador	
Majoritarian	4	4	9	6	23
Consensual	10	11	5	8	34
Total	14	15	14	14	57
		Below the median	Above the median		
Majoritarian		8	15		23
Consensual		21	13		34
Total		29	28		57

inequality above the median. We can therefore conclude that the unconditional relationship between income inequality and constitution is consistent with our theory.

We now present the results of logit regressions when the relationship between inequality and constitution is analysed conditioning for different variables that may potentially affect the choice of the constitution. The most important variable is ethnic

Table 2  
(Continued)

(c) Income distribution in the whole sample. Classification: presidential regimes with PR are classified as majoritarian democracies					
	1 <sup>st</sup> quartile 21.5 ≤ gini ≤ 35.45	2 <sup>nd</sup> quartile 37.11 ≤ gini ≤ 43	3 <sup>rd</sup> quartile 45 ≤ gini ≤ 50.11	4 <sup>th</sup> quartile 51 ≤ gini ≤ 68.6	Total
Majoritarian	Ukraine, Belarus, Nepal, South Korea, Sri Lanka, Bangladesh	Pakistan, Malaysia, Paraguay, Ghana, Uruguay, Argentina, India	Dominican R., Bahamas, Barbados, Trinidad & T., Venezuela, Philippines, Japan, Uganda, Singapore, El Salvador, France, Bolivia, Guatemala, Zambia	Thailand, Jamaica, Peru, Brazil, Mexico, Nicaragua, Botswana, Chile, Colombia, Honduras, Zimbabwe, Ecuador, Malawi, Turkey	
Consensual	Slovak R., Hungary, Romania, Bulgaria, Czech R., Poland, Latvia, Taiwan	Spain, Italy, Germany, Portugal, Greece, Estonia, Fiji, Senegal			
Majoritarian	6	7	14	13	40
Consensual	8	8	0	1	17
Total	14	15	14	14	57
	Below the median		Above the median		
Majoritarian	13		27		40
Consensual	16		1		17
Total	29		28		57

fragmentation whose importance for constitutional choice has been emphasised by Lijphart (1999) and Aghion *et al.* (2004). We always control for it by including the variables *ethnic* and *language* from Alesina *et al.* (2003). This allows us to disentangle different kinds of heterogeneity as the first one is based on a broad measure of ethnicity while the second is strictly based on language. We also control for religious fractionalisation using the variable *religion* taken from the same authors, but we do not include it in the baseline specification because Alesina *et al.* (2003) argue that the endogeneity problems for this variable may be more serious.<sup>46</sup>

We control for country size and level of development by including the log of population in 1960 (*lpop\_60*) and the GDP per capita expressed relative to the US in 1960 (*y\_60*) taken from the Penn World Table 6.1.<sup>47</sup> We consider three regional dummies to

<sup>46</sup> The variables *ethnic*, *language* and *religion* take values in the range between zero and one that are increasing in the degree of ethnic, linguistic and religious fractionalisation respectively. There are no data for the variable *language* for El Salvador.

<sup>47</sup> There are a few countries for which the data on the level of income per capita relative to the US and the size of population are not available in 1960. In these cases, we have taken the first year available. This is equivalent to assuming that the ratio between the GDP per capita of these countries and that one of the US has remained unchanged between 1960 and the first year available. As a robustness check, we have also run regressions with the log of the GDP per capita in 1960. For the countries where GDP per capita in 1960 was not available, we have multiplied their per capita income relative to the US in the first year available with US per capita income in 1960. Using the log of this variable instead of the GDP per capita expressed relative to US yields basically the same results.

Table 3  
*Constitution Selection and Income Inequality in Parliamentary Democracies*

Sample: Parliamentary democracies – Logit estimates							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Dep. var.	<i>maj</i>	<i>maj</i>	<i>maj</i>	<i>maj</i>	<i>maj</i>	<i>maj</i>	<i>maj</i>
<i>giniycal</i>	0.03 (0.012)***	0.031 (0.012)***	0.03 (0.012)**	0.033 (0.016)**	0.032 (0.016)*	0.02 (0.015)	0.033 (0.012)***
<i>ethnic</i>	0.16 (0.649)	0.469 (0.911)	0.152 (0.637)	0.762 (0.715)	0.339 (0.676)	-0.517 (0.818)	-0.129 (0.703)
<i>language</i>	0.233 (0.504)	0.031 (0.634)	0.096 (0.531)	-0.758 (0.759)	-0.2 (0.596)	0.561 (0.711)	0.486 (0.506)
<i>lpop_60</i>		[0.626]					
<i>y_60</i>			[0.555]				
<i>regional dummies</i>				[0.215]			
<i>prot80, catho80, confu</i>					[0.234]		
<i>colonial origins</i>						[0.238]	
<i>religion</i>							[0.173]
Observations	31	31	31	31	31	31	31
Pseudo R-squared	0.2	0.21	0.21	0.31	0.29	0.31	0.26

Notes: Robust standard errors in parentheses. \* Significant at 10%. \*\* Significant at 5%. \*\*\* Significant at 1%. Logit coefficients are marginal effects on the probability of having a majoritarian system evaluated at the mean. The table includes p-values for Chi-square test of joint significance of the control sets. Regional dummies include *africa* and *asiae*. Regional dummy *laam* has not been included because all four parliamentary democracies in Latin America are majoritarian. Colonial origins include *col\_uk* and *col\_oth* but not *col\_esp* as there are no Spanish-Portuguese colonies in the sample.

take into account the role of geography. In particular, we use a dummy variable for continental location in Africa (*africa*), in eastern and southern Asia (*asiae*) and southern and central America including the Caribbean (*laam*). To take into account the possible effects of religious and cultural factors, we control for the percentage of the population in each country professing the Protestant religion in 1980 (*prot80*), the percentage of the population belonging to the Roman Catholic religion in 1980 (*catho80*) and, if the majority of population is Confucian-Buddhist-Zen (*confu*). PT argue that ex-British colonies tend to be parliamentary and majoritarian while all former Spanish-Portuguese colonies are presidential. To take into account these effects, we control for British (*col\_uk*), for Spanish-Portuguese (*col\_esp*) and other (*col\_oth*) colonial origins. All the above variables are taken from the PT dataset.

Table 3 presents the relationship between constitution and income inequality in the sample of parliamentary democracies. Column (1) shows the results for our baseline specification where we consider the degree of income inequality and of ethnic fragmentation. Higher inequality is positively correlated with a majoritarian electoral system and this relationship is statistically significant at 1%. The quantitative effect of an increase in income inequality on the probability of adopting a majoritarian system is also very high as the marginal effect at the mean is 0.03.<sup>48</sup> In columns (2) and (3) we control for the population and level of income respectively. In column (4), we include dummies for Africa and Asia while the dummy for Latin America is omitted because the four parliamentary democracies in this region are all majoritarian. Column (5) shows

<sup>48</sup> Recall that the Gini coefficient employed is measured in a scale from 0 to 100, which means that an increase of one point in inequality increases the probability of adopting a majoritarian system by 3%.

the results when we add the religious characteristics of each country that are likely to be correlated with cultural factors. In all specifications, we find that the relationship between inequality and constitution is unchanged with respect to the baseline one.<sup>49</sup> In column (6), we control for colonial origins and find that the correlation between income inequality and majoritarian democracy has the expected sign but it is not statistically significant at standard levels. This is due to the inclusion of the dummy variable for former British colonies.<sup>50</sup> In this sample, 8 out of 9 ex-British colonies have a majoritarian electoral rule. It is worth noting that these former British colonies are also very unequal. The mean Gini coefficient for these 9 countries is 46.58 and the most equal one has a coefficient of 38.1. This in turn implies that all former British colonies have a degree of inequality above average (see Table 1). Such collinearity between the Gini coefficient and British colonial origin, combined with measurement errors in inequality, could be at the root of inequality becoming insignificant. In other words, while controlling for colonial origins substantially weakens our results, it is not clear to us whether former colonies have chosen a certain type of democracy to imitate the coloniser's institutions or because these type of institutions suited well with their economic fundamentals. Another interpretation is that British colonies borrowed not only the majoritarian electoral law but also the pro-market attitude of England. As the latter might induce high inequality, this may explain the correlation between British colonial origins and high inequality observed in the data.<sup>51</sup> We have therefore included in the regression a variable of *regulatory quality*, taken from Kaufmann *et al.* (2005), which measures the incidence of market-unfriendly policies.<sup>52</sup> We have used the average value of the first two years available in the dataset, 1996 and 1998. Given that many constitutions have been chosen much before the 1990s, we are here assuming that this variable has not been subject to large time variations. As there could be endogeneity problems with this specification, we have not included it in Table 3. The results (available from the authors) are encouraging. The Gini coefficient is now very similar to all other specifications (0.029) and its p-value is 5.6%. The dummy variable for former British colonies is still statistically significant while the regulatory quality variable is not. Finally, column (7) shows that the results are robust when we control for religious fractionalisation.

Table 4 reports the results for the same analysis using the whole sample with the classification based on the electoral rule. While the unconditional correlation between income inequality and electoral system in this sample is not very high, the correlation becomes strong when we control for ethnic fragmentation. In fact, in the baseline specification reported in column (1) we find that the marginal effect evaluated at the mean of an increase in inequality on the probability of adopting a majoritarian electoral rule is 0.016 and this is statistically significant at 5% level. The linguistic fractionalisation coefficient has also a positive statistically significant effect. The same

<sup>49</sup> The Gini coefficient in column (5) is less precisely estimated but the p-value is 5.2%.

<sup>50</sup> There are no Spanish-Portuguese colonies in the sample and the inclusion of *col\_oth* alone would not change the results with respect to the baseline specification. When we control only for *col\_uk*, the Gini estimate is 0.02 and the p-value 12.4%.

<sup>51</sup> We thank an anonymous referee for bringing this to our attention.

<sup>52</sup> In particular, this variable takes into account price controls or inadequate bank supervision, as well as perceptions of the burdens imposed by excessive regulation in areas such as foreign trade and business development.

Table 4  
*Constitution Selection and Income Inequality in the Whole Sample*  
*(Classification Based on the Electoral Rule)*

Whole sample – Logit estimates							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Dep. var.	<i>maj</i>	<i>maj</i>	<i>maj</i>	<i>maj</i>	<i>maj</i>	<i>maj</i>	<i>maj</i>
<i>giniycal</i>	0.016 (0.007)**	0.016 (0.007)**	0.017 (0.007)**	0.015 (0.009)	0.032 (0.014)**	0.029 (0.013)**	0.023 (0.009)***
<i>ethnic</i>	-0.755 (0.615)	-0.757 (0.615)	-0.729 (0.629)	-0.617 (0.57)	-0.81 (0.511)	-1.089 (0.525)**	-0.782 (0.504)
<i>language</i>	1.344 (0.498)***	1.344 (0.498)***	1.414 (0.499)***	0.843 (0.542)	1.081 (0.402)***	1.277 (0.398)***	1.403 (0.411)***
<i>lpop_60</i>		[0.980]					
<i>y_60</i>			[0.665]				
<i>regional dummies</i>				[0.518]			
<i>prot80, catho80, confu</i>					[0.027]		
<i>colonial origins</i>						[0.004]	
<i>religion</i>							[0.012]
Observations	56	56	56	56	56	56	56
Pseudo R-squared	0.21	0.21	0.21	0.24	0.39	0.43	0.34

Notes: Robust standard errors in parentheses. \* Significant at 10%. \*\* Significant at 5%. \*\*\* Significant at 1%. Logit coefficients are marginal effects on the probability of having a majoritarian system evaluated at the mean. The table includes *p*-values for Chi-square test of joint significance of the control sets. Regional dummies include *africa, asiae, laam*. Colonial origins include *col\_uk, col\_esp, col\_oth*.

result is obtained controlling for population and income (columns (2) and (3)). The Gini coefficient has the same magnitude but it is less precisely estimated when we include the three regional dummies. The *p*-value of the coefficient is 10.7% however. In columns (5) and (6) we control for religious and for colonial origins respectively. The estimated Gini coefficient is pretty large (about 0.03) and significant at 5% in both specifications. Results are also robust when controlling for religious fractionalisation which is positively correlated with plurality rule (see column (7)).

Table 5 shows the results when presidential regimes with PR are classified as majoritarian systems. The relationship between inequality and majoritarian democracy is very strong. The marginal effect on the probability of adopting a majoritarian democracy evaluated at the mean is large, about 0.024, and statistically significant at 1% level in all specifications.<sup>53</sup>

Finally, we have performed the following three robustness checks whose results are available from the authors. First, we have estimated the relationship between inequality and constitution also with probit and linear probability models. This yielded similar results. Second, we have used three other Gini coefficients: the unadjusted Gini; the Gini adjusted if the data are based on net income rather than gross (along with the adjustment for income versus expenditure); the Gini coefficient with a further adjustment if the information is based on households instead than individuals. Using these Gini coefficients yields very similar estimates in all samples. Third, we have tried to understand if the quality of the Gini coefficients could play a

<sup>53</sup> We have also replicated the same analysis excluding the presidential regimes with PR. The results are very close to those obtained for the sample of parliamentary democracies reported in Table 3.

Table 5  
*Constitution Selection and Income Inequality When Presidential Regimes With PR are Classified as Majoritarian Democracies*

Whole sample – Logit estimates							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Dep. var.	<i>maj</i>	<i>maj</i>	<i>maj</i>	<i>maj</i>	<i>maj</i>	<i>maj</i>	<i>maj</i>
<i>giniyci</i>	0.024 (0.006)***	0.024 (0.006)***	0.023 (0.006)***	0.025 (0.008)***	0.025 (0.007)***	0.022 (0.008)***	0.025 (0.007)***
<i>ethnic</i>	0.153 (0.283)	0.222 (0.299)	0.125 (0.267)	0.339 (0.329)	0.31 (0.311)	0.06 (0.283)	0.12 (0.296)
<i>language</i>	0.162 (0.199)	0.129 (0.227)	0.028 (0.222)	-0.071 (0.358)	0.072 (0.214)	0.054 (0.229)	0.137 (0.208)
<i>lpop_60</i>		[0.538]					
<i>y_60</i>			[0.167]				
<i>regional dummies</i>				[0.297]			
<i>prot80, catho80, confu</i>					[0.198]		
<i>colonial origins</i>						[0.401]	
<i>religion</i>							[0.261]
Observations	56	56	56	56	56	56	56
Pseudo R-squared	0.28	0.29	0.30	0.33	0.34	0.32	0.31

Notes: Robust standard errors in parentheses. \* Significant at 10%. \*\* Significant at 5%. \*\*\* Significant at 1%. Logit coefficients are marginal effects on the probability of having a majoritarian system evaluated at the mean. The Table includes p-values for Chi-square test of joint significance of the control sets. Regional dummies include *africa* and *asiae*. Regional dummy *laam* has not been included because all nineteen countries in Latin America enter as majoritarian. Colonial origins include *col\_uk* and *col\_esp* but not *col\_esp* because all fifteen former Spanish-Portuguese colonies in the sample enter as majoritarian democracies.

role in our estimate even though, in principle, the inclusion of lower quality data should work against our hypothesis. To this purpose, we have first restricted the sample to high quality data only and the estimates are similar to those presented above. A second check was to add a dummy variable for the quality (high or low) of the Gini coefficient in each specification. Again, the estimate for income inequality remained basically unchanged while the estimate of the variable for the quality of the Gini coefficient was always statistically insignificant. Therefore, we conclude that there is a strong positive relationship between income inequality and majoritarian democracy as predicted by our model.

## 8. Conclusions

This article shares with other recent contributions in political economics the premise that constitutional principles are of great importance in shaping fiscal policy outcomes in representative democracies. We show that generally consensual democracies have higher taxation and bigger governments than majoritarian ones. But additionally we demonstrate that, once institutions are viewed as endogenous, consensual democracy is more difficult to sustain politically in a more unequal society since greater inequality tends to undermine the stability of the coalition supporting it. The results of our empirical analysis are consistent with the theoretical finding that more unequal societies are expected to adopt a majoritarian constitution, while relatively equal countries are more likely to choose a consensual constitution.

The results of our model concerning the effects of inequality on institutional choice, as well as on fiscal policy, appear to be not only significant *per se* but, for the guidelines they offer for future empirical research on the economic consequences of constitutions. In particular, they provide a firm theoretical background for the intuitive claim that the assignment of constitutions across countries is not random but reflects a number of ‘fundamentals’, among which the extent of income inequality is of special importance.

Future constitutional choices and new data on income inequality will provide further information to test our theory. On the one hand, it will be interesting to observe the constitutions chosen by new countries escaping from dictatorship and moving towards democracy. On the other hand, it will also be possible to see whether democratic countries experiencing a sensible increase or reduction in income inequality will question or change their current constitutional framework.

## Appendix

### A.1. Proof of Proposition 1

We first prove that only the rich run for office and then that the set of citizen-candidates running for office is not empty.

*Step 1.* Assume that at least one rich candidate runs for office. Would anyone else run for office? The answer is no. If a middle class agent also runs, he would be defeated by the rich candidate because both the rich and the poor would vote for the rich. The poor find it convenient to vote for the rich candidate because in their eyes he is the less bad of the two of them: he offers to the poor none of their preferred public good but demands lower taxes. Similarly, if a poor agent runs for office against a rich candidate, he would be defeated by the vote of the middle class and the rich. Lastly, notice it cannot be the case that a candidate from each group runs for office. Indeed, the middle class candidate would win the election with certainty in that instance (recall that  $m^b > \max\{m^p, m^r\}$  by assumption), and therefore neither a poor nor a rich candidate would run against him.

*Step 2.* We now demonstrate that the set of citizen-candidates running for office is not empty, i.e. that at least one rich candidate runs for office. Let  $p$  denote the probability of victory for a rich citizen-candidate (in a symmetric equilibrium, this will be the same across identical citizen-candidates). A rich agent wants to run for office if and only if the expected gain of running exceeds its cost, namely if  $\{p[w^r(\tau^r, G^r) + k] + (1 - p)w^r(\tau^r, G^r)\} - w^r(\bar{\tau}, \bar{G}) \geq \varepsilon$ , where  $(\bar{\tau}, \bar{G})$  denotes the policy vector implemented if he does not run and the term in the graph parenthesis is the expected utility if he runs, given that only rich candidates do so. To show that the set of citizen-candidates running for office is not empty, it is sufficient to demonstrate that this condition is satisfied when only one rich person runs for office for all  $(\bar{\tau}, \bar{G}) \in ([0, 1] \times \mathbb{R}_+^3)$ . To see this, observe that in this case  $p = 1$  and the participation constraint of the rich candidate reads  $w^r(\tau^r, G^r) + k - w^r(\bar{\tau}, \bar{G}) \geq \varepsilon$ . Since the policy vector  $(\tau^r, G^r)$  maximises the welfare of the rich,  $w^r(\tau^r, G^r) > w^r(\bar{\tau}, \bar{G})$ , for all  $(\bar{\tau}, \bar{G}) \in ([0, 1] \times \mathbb{R}_+^3)$  with  $(\bar{\tau}, \bar{G}) \neq (\tau^r, G^r)$ , and given that  $k \geq \varepsilon$ , the participation constraint of the rich candidate always holds with strict inequality when  $p = 1$ .

### A.2. Proof of Proposition 2

In this Appendix we show that a value of  $\phi$  exists, that we call  $\phi^*$ , such that the utility derived by the middle class from the government coalition with the poor  $w_{1,b,p}^b$  is higher than the corresponding utility from the coalition with the rich  $w_{1,b,r}^b$  if  $\phi < \phi^*$ , and that the opposite is true



whenever  $\phi > \phi^*$ . To this end, we first show that  $w_{1,b,r}^b$  is monotonically increasing in  $\phi$ , while  $w_{1,b,p}^b$  is strictly monotonically decreasing in  $\phi$ . Then, to prove that there is a single crossing between these two schedules in the range where  $\phi \in (0,1)$ , we show that  $w_{1,b,p}^b$  is higher than  $w_{1,b,r}^b$  at  $\phi = 0$  and that the opposite holds at  $\phi = 1$ .

The utility of the middle class in the government coalition with the rich  $w_{1,b,r}^b$  is defined by the maximisation problem (5) subject to the participation constraint of the rich (4). Differentiating (5) with respect to  $\phi$  and applying the envelope theorem we get that

$$\frac{dw_{1,b,r}^b}{d\phi} = -H_g(g_{1,b,r}^b) \frac{\partial g_{1,b,r}^r}{\partial \phi} \geq 0. \quad (11)$$

Indeed, assuming that (4) is binding and applying the implicit function theorem we get

$$\frac{\partial g_{1,b,r}^r}{\partial \phi} = - \frac{[(1 - \tau_{2,r,p})y^r + H(g_{2,r,p}^r)] - (1 - \tau_{2,p,b})y^r}{H_g(g_{1,b,r}^r)} < 0 \quad (12)$$

given that the numerator is positive because it is the difference between the utility of the rich when they are agenda setter at round 2 (which is greater than  $y^r$ ) and their utility under the poor and middle class government coalition (which is lower than  $y^r$ ). In this case  $dw_{1,b,r}^b/d\phi$  is strictly positive. Instead, if the participation constraint of the rich (4) is not binding, then  $w_{1,b,r}^b$  is at its global maximum,  $\partial g_{1,b,r}^r/\partial \phi = 0$  and  $dw_{1,b,r}^b/d\phi = 0$ . Hence, the result in (11) shows that  $w_{1,b,r}^b$  is monotonically increasing in  $\phi$ .

The utility of the middle class in the government coalition with the poor  $w_{1,b,p}^b$  is defined by the maximisation problem (8) subject to the participation constraint of the poor (7). If we differentiate (8) with respect to  $\phi$  and apply the envelope theorem we obtain that

$$\frac{dw_{1,b,p}^b}{d\phi} = -H_g(g_{1,b,p}^b) \frac{\partial g_{1,b,p}^p}{\partial \phi} < 0 \quad (13)$$

given that from (7)

$$\frac{\partial g_{1,b,p}^p}{\partial \phi} = - \frac{y^p - [(1 - \tau_{2,p,b})y^p + H(g_{2,p,b}^p)]}{H_g(g_{1,b,p}^p)} > 0. \quad (14)$$

Indeed, the numerator on the right hand side of (14) is negative because it is the difference between  $y^p$  and the utility of the poor when they are agenda setter at a round 2 (which is greater than  $y^p$ ). The result in (13) means that  $w_{1,b,p}^b$  is strictly monotonically decreasing in  $\phi$ .

Then, it remains to show that  $w_{1,b,p}^b(0) > w_{1,b,r}^b(0)$  and that  $w_{1,b,p}^b(1) < w_{1,b,r}^b(1)$ . We prove the first inequality by showing that the participation constraints of the rich and the poor at  $\phi = 0$  imply that, for any given level of tax rate chosen by the middle class, the rich have to be compensated with a greater amount of their preferred public good. Indeed, the participation constraint of the poor at  $\phi = 0$  implies that

$$H(g_{1,b,p}^p) = \tau_{1,b,p}y^p \quad (15)$$

while from the participation constraint of the rich we get<sup>54</sup>

$$H(g_{1,b,r}^r) = [(1 - \tau_{2,r,p})y^r + H(g_{2,r,p}^r)] - (1 - \tau_{1,b,r})y^r. \quad (16)$$

The expression in the square brackets in the right hand side of (16) is the utility of the rich when they are agenda setter at round 2 and it is clearly greater than  $y^r$ . Hence, it is of course the case that

<sup>54</sup> The participation constraint of the rich is always binding at  $\phi = 0$  as their expected utility at round 2 is greater than  $y^r$ .

$$H(g_{1,b,r}^r) > \tau_{1,b,r} y^r. \tag{17}$$

By combining (15) and (17) and taking into account also the fact that  $y^r > y^b$ , one can easily verify that for any given level of tax rate  $\tau_{1,b,r} = \tau_{1,b,p} = \tau$  we have that  $g_{1,b,r}^r > g_{1,b,p}^b$ . This in turn implies that the middle class agenda setter obtains a higher level of utility by making a coalition with the poor instead than with the rich, i.e.  $w_{1,b,p}^b(0) > w_{1,b,r}^b(0)$ .

At  $\phi = 1$  the utility of the middle class under the government coalition with the poor  $w_{1,b,p}^b$  is equal to  $y^b$ . This result can be obtained by observing that at  $\phi = 1$  the maximisation problem of the middle class is subject to the participation constraint of the poor where they are agenda setter with probability one at round 2 and maximise their utility subject to the constraint of giving to the middle class a level of utility equal to the *status quo* (which corresponds to their level of income  $y^b$ ).<sup>55</sup>

From the maximisation problem of the middle class, when the agenda setter forms a government coalition with the rich, it is immediate to verify that  $w_{1,b,r}^b$  is always greater than  $y^b$  at  $\phi = 1$ . Indeed, from the participation constraint of the rich at  $\phi = 1$ , i.e.  $(1 - \tau_{1,b,r})y^r + H(g_{1,b,r}^r) \geq (1 - \tau_{2,p,b})y^r$ , we know that the middle class could implement the following policy:  $0 < \tau_{1,b,r} \leq \tau_{2,p,b}$ ,  $g_{1,b,r}^r = 0$ ,  $g_{1,b,r}^b = \tau_{1,b,r}\bar{y}$ . This policy satisfies the participation constraint of the rich and gives to the middle class agenda setter a higher utility than her income level  $y^b$ . Given that the optimal policy gives to the middle class a higher utility than this policy and, therefore, of  $y^b$ , it is clear that  $w_{1,b,r}^b(1) > w_{1,b,p}^b(1)$ .

### A.3. Proof of Result 1

In this Appendix we show that under the assumptions stated in the main text the following inequalities hold for all  $\phi$ :  $\tau^r < \tau_{1,b,r} < \tau_{1,b,p}$ . To this aim, we first prove that  $\tau^r < \tau_{1,b,r} \leq \tau^b$  by showing that  $\tau_{1,b,r} = \tau^r$  at  $\phi = 0$ ,  $\tau_{1,b,r} = \tau^b$  at  $\phi = 1$  and that  $\tau_{1,b,r}$  is monotonically increasing in  $\phi$ . Next, we show that  $\tau^b < \tau_{1,b,p}$ .

At  $\phi = 0$  the rich are the agenda setter with probability one at round 2, and they form the government coalition with the poor. If the income of the poor is equal to zero, the fiscal policy implemented at the second round corresponds to the dictatorial policy of the rich as the poor do not need to be compensated with a positive amount of their preferred public good. Thus, to form a government coalition at round 1, the middle class has to propose a policy to the rich such that their level of utility is the same they obtain at round 2. Given that the latter is equal to its global unconstrained maximum, the middle class can only implement the dictatorial policy of the rich, that is:  $\tau_{1,b,r} = \tau_{2,r,p} = \tau^r$ ,  $g_{1,b,r}^r = g_{2,r,p}^r = \tau^r \bar{y}$  and  $g_{1,b,r}^b = 0$ . In other words, the policy implemented (and the tax rate chosen) by the government coalition formed by the middle class and the rich at  $\phi = 0$  (if  $y^p = 0$ ) is the same as the one in majoritarian democracy.

We have previously shown that  $\tau_{1,b,r} = \tau^b$  for all values of  $\phi$  such that the participation constraint of the rich is not binding and that this is always the case at  $\phi = 1$  if  $y^p = 0$ .

To prove that  $\tau_{1,b,r}$  is monotonically increasing in  $\phi$ , we differentiate the first order condition (6) with respect to  $\phi$  by taking into consideration the fact that from the participation constraint of the rich (4),  $g_{1,b,r}^r = g_{1,b,r}^r[\phi; \tau_{1,b,r}(\phi)]$  and  $\partial g_{1,b,r}^r / \partial \tau_{1,b,r} = y^r / H_g(g_{1,b,r}^r)$ .<sup>56</sup> After some algebra we obtain

<sup>55</sup> Formally, the maximisation problem when  $\phi = 1$  is the following:

$$\begin{aligned} \max_{\{\tau_{1,b,p}\}} w_{1,b,p}^b &= (1 - \tau_{1,b,p})y^b + H(\tau_{1,b,p}\bar{y} - g_{1,b,p}^b) \\ \text{s.t. } (1 - \tau_{1,b,p})y^p + H(g_{1,b,p}^p) &\geq \max_{\{\tau_{2,p,b}\}} (1 - \tau_{2,p,b})y^p + H(\tau_{2,p,b}\bar{y} - g_{2,p,b}^b) \\ \text{s.t. } w_{2,p,b}^b &\equiv (1 - \tau_{2,p,b})y^b + H(g_{2,p,b}^b) = y^b \end{aligned}$$

and it is immediate to verify that  $w_{1,b,p}^b = w_{2,p,b}^b = y^b$ .

<sup>56</sup> We recall that  $\tau_{1,b,r} = \tau^b$  when the participation constraint is not binding.

$$\begin{aligned} & \frac{\partial \tau_{1,b,r}}{\partial \phi} \left\{ H_{gg}(g_{1,b,r}^b) \left[ \bar{y} - \frac{y^r}{H_g(g_{1,b,r}^r)} \right]^2 + H_{gg}(g_{1,b,r}^r) \frac{(y^r)^2 H_g(g_{1,b,r}^b)}{[H_g(g_{1,b,r}^r)]^3} \right\} \\ & + \frac{\partial g_{1,b,r}^r}{\partial \phi} \left\{ -H_{gg}(g_{1,b,r}^b) \left[ \bar{y} - \frac{y^r}{H_g(g_{1,b,r}^r)} \right] + H_{gg}(g_{1,b,r}^r) \frac{y^r H_g(g_{1,b,r}^b)}{[H_g(g_{1,b,r}^r)]^2} \right\} = 0 \end{aligned} \quad (18)$$

which allows us to determine the sign of  $\partial \tau_{1,b,r} / \partial \phi$ . Indeed, notice that the term in graph parenthesis that multiplies  $\partial \tau_{1,b,r} / \partial \phi$  is always negative and from (12) we know that  $\partial g_{1,b,r}^r / \partial \phi < 0$ . Therefore, the sign of the relationship between  $\tau_{1,b,r}$  and  $\phi$  depends on the sign of the term in the second graph parenthesis of (18) which multiplies  $\partial g_{1,b,r}^r / \partial \phi$ . In particular,  $\partial \tau_{1,b,r} / \partial \phi \geq 0$  if and only if

$$-H_{gg}(g_{1,b,r}^b) \left[ \bar{y} - \frac{y^r}{H_g(g_{1,b,r}^r)} \right] + H_{gg}(g_{1,b,r}^r) \frac{y^r H_g(g_{1,b,r}^b)}{[H_g(g_{1,b,r}^r)]^2} \leq 0 \quad (19)$$

and *vice versa*. Even though in general it is not possible to give a definite sign to the left hand side of (19), assuming a power function for the utility of the public good it turns out that inequality (19) is satisfied if

$$\frac{A(g_{1,b,r}^r)^\alpha}{\tau_{1,b,r} y^r} \leq \frac{1}{\alpha} \quad (20)$$

where the numerator of the left hand side of (20) is the utility that the rich get from their preferred public good provided and the denominator represents the taxes they pay. It is useful to rewrite inequality (20) as

$$A(g_{1,b,r}^r)^\alpha - \tau_{1,b,r} y^r \leq (1 - \alpha) A(g_{1,b,r}^r)^\alpha. \quad (21)$$

By using a power function specification for  $H(\cdot)$  and subtracting  $y^r$  to both sides, we can rewrite the participation constraint of the rich (4) as

$$-\tau_{1,b,r} y^r + A(g_{1,b,r}^r)^\alpha = (1 - \phi) [-\tau_{2,r,p} y^r + A(g_{2,r,p}^r)^\alpha] - \phi \tau_{2,p,b} y^r. \quad (22)$$

The substitution of (22) into (21) leads to the following weak inequality

$$(1 - \phi) [-\tau_{2,r,p} y^r + A(g_{2,r,p}^r)^\alpha] - \phi \tau_{2,p,b} y^r - (1 - \alpha) A(g_{1,b,r}^r)^\alpha \leq 0. \quad (23)$$

Now, if we take into consideration the fact that the dictatorial policy of the rich is implemented at round 2 under the rich and poor coalition (see the discussion above), we are able to rewrite (23) as<sup>57</sup>

$$(1 - \phi) (1 - \alpha) \alpha^{\frac{\alpha}{1-\alpha}} A^{\frac{1}{1-\alpha}} \left( \frac{\bar{y}}{y^r} \right)^{\frac{\alpha}{1-\alpha}} - \phi \tau_{2,p,b} y^r - (1 - \alpha) A(g_{1,b,r}^r)^\alpha \leq 0. \quad (24)$$

Notice that only the first component of the left hand side of (24) is positive and this term decreases until zero as  $y^r$  increases.<sup>58</sup> Therefore, there exists a  $y^r$  sufficiently high relatively to  $\bar{y}$  such that (24) is always satisfied, which in turn means that  $\partial \tau_{1,b,r} / \partial \phi \geq 0$ .<sup>59</sup>

<sup>57</sup> We are using the fact that  $\tau_{2,r,p} = \tau^r$ ,  $g_{2,r,p}^r = \tau^r \bar{y}$  with  $\tau^r = (\alpha A \bar{y}^\alpha / y^r)^{\frac{1}{1-\alpha}}$ .

<sup>58</sup> The first component of (23) and (24) represents the net gain (with respect to the status quo) of the rich in utility terms when they are agenda setter at round 2 multiplied by  $(1 - \phi)$ . Clearly, this component goes to zero as  $\phi$  tends to one.

<sup>59</sup> Using the fact that the dictatorial policy of the rich is implemented at  $\phi = 0$  and therefore  $g_{1,b,r}^r(0) = \tau^r \bar{y}$ , it is immediate to verify that the left-hand side of (24) is equal to zero at  $\phi = 0$ . Moreover, notice that the left hand side of (24) is more likely to be positive when  $\phi$  is small. In this case  $\tau_{1,b,r}$  would be decreasing in  $\phi$ . When  $y^r$  is not sufficiently high, the numerical simulations confirm that  $\tau_{1,b,r}$  is decreasing for values of  $\phi$  low and then it becomes increasing when  $\phi$  is big enough.

At this point we know that  $\tau_{1,b,r}$  is monotonically increasing in  $\phi$ , that  $\tau_{1,b,r}(0) = \tau^r$  and that  $\tau_{1,b,r}(1) = \tau^b$  and this implies that  $\tau^r < \tau_{1,b,r} \leq \tau^b$ .

We now want to prove that  $\tau_{1,b,p}$  is always higher than  $\tau^b$  and to this aim we show that  $\tau_{1,b,p} = \tau^b$  at  $\phi = 0$  and that  $\tau_{1,b,p}$  is increasing in  $\phi$ . The first point is easily shown by observing that the middle class agenda setter in the coalition with the poor can implement her dictatorial policy at  $\phi = 0$  if  $y^p = 0$  because the participation constraint of the poor (7) is not binding. To prove the second point we differentiate the first order condition (9) with respect to  $\phi$  by taking into account that from the participation constraint of the poor (7),  $g_{1,b,p}^p = g_{1,b,p}^p[\phi; \tau_{1,b,p}(\phi)]$  and  $\partial g_{1,b,p}^p / \partial \tau_{1,b,p} = y^p / H_g(g_{1,b,p}^p)$ . After rearranging terms we get

$$\begin{aligned} & \frac{\partial \tau_{1,b,p}}{\partial \phi} \left\{ H_{gg}(g_{1,b,p}^b) \left[ \bar{y} - \frac{y^p}{H_g(g_{1,b,p}^p)} \right] + H_{gg}(g_{1,b,p}^p) \frac{(y^p)^2 H_g(g_{1,b,p}^b)}{[H_g(g_{1,b,p}^p)]^3} \right\} + \\ & + \frac{\partial g_{1,b,p}^p}{\partial \phi} \left\{ -H_{gg}(g_{1,b,p}^b) \left[ \bar{y} - \frac{y^p}{H_g(g_{1,b,p}^p)} \right] + H_{gg}(g_{1,b,p}^p) \frac{y^p H_g(g_{1,b,p}^b)}{[H_g(g_{1,b,p}^p)]^2} \right\} = 0. \end{aligned} \quad (25)$$

From (14) we know that  $\partial g_{1,b,p}^p / \partial \phi > 0$  and, given that the term in the first graph parenthesis is always negative, the sign of  $\partial \tau_{1,b,p} / \partial \phi$  depends on the sign of the term in the second graph parenthesis that multiplies  $\partial g_{1,b,p}^p / \partial \phi$ . If

$$-H_{gg}(g_{1,b,p}^b) \left[ \bar{y} - \frac{y^p}{H_g(g_{1,b,p}^p)} \right] + H_{gg}(g_{1,b,p}^p) \frac{y^p H_g(g_{1,b,p}^b)}{[H_g(g_{1,b,p}^p)]^2} > 0 \quad (26)$$

then  $\partial \tau_{1,b,p} / \partial \phi > 0$ , and *vice versa*. In this case we do not need to use a power function specification for  $H(\cdot)$  because using the fact that  $y^p = 0$  and  $g_{1,b,p}^p > 0$  for all  $\phi > 0$ , inequality (26) becomes  $-H_{gg}(g_{1,b,p}^b) \bar{y} > 0$ , which is always satisfied given that  $H_{gg}(\cdot) < 0$ . This implies that  $\tau_{1,b,p}$  is monotonically increasing in  $\phi$  and its minimum level is equal to  $\tau^b$  at  $\phi = 0$ .

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