The following individuals certify that they have read, and recommend to the Faculty of Graduate and Postdoctoral Studies for acceptance, a thesis/dissertation entitled:

Democracy, Domestic Institutions, and Inequality: Evidence from Emerging Countries and South Korea

Submitted by Sung Wook Park in partial fulfillment of the requirements for

the degree of Master of Arts

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Abstract

This study examines how democracy and globalization and their interaction have shaped economic inequality in the emerging world. Previous studies offer conflicting theoretical expectations and mixed empirical evidence of the effects of globalization and democracy on economic inequality. Also, the nexus among democracy, globalization, and inequality in middle-income countries has received less attention than the same relationship in advanced industrial democracies. Conventional wisdom suggests that democracy creates more egalitarian society, whereas globalization is considered to be one of the common factors that resulted higher economic inequality.

My study utilizes a mixed methods approach. I conduct cross-national time-series analyses as well as a case study on South Korea (hereafter, Korea). Surprisingly, contrary to the theoretical expectation, my quantitative analysis finds that democracy is not related to income inequality, regardless of whether a dichotomous or continues measure of democracy is used. However, globalization, as measured by trade openness and FDI, is strongly associated with increased income inequality.

Finally, the Korean case suggests that domestic political variables such as government partisanship and party competition influence government efforts to reduce economic inequality, although democracy or democratization do not automatically produce a more egalitarian society. Evidence from the case study suggests that it could be the case that many middle-income countries do not have established left-right politics in the early stage of democratization, creating a situation in which the poor and middle class have limited political representation.
Lay Summary

We have witnessed two grand transformations in last few decades: the third waves of globalization and democratization. Some believe that the two have brought positive influence while others argue that globalization only has increased economic inequality but democracy has failed to protective people from this vicious global force.

There are theoretical reasons to believe democracy would reduce economic inequality. By using statistical analyses and a case study on South Korea, my thesis investigates whether income inequality has increased due to globalization, and whether democracy effectively reduced income inequality.

My study did find that globalization is associated with increased income inequality. My case study suggests that democracy and domestic political factors such as party politics and governments partisanship do matter in terms of government redistributive and welfare efforts.
Preface

This thesis is original, unpublished, independent work by the author, Sung Wook Park.
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1. Introduction

We have witnessed two grand transformations in last few decades: the third waves of globalization and democratization. These have both had a positive influence on the lives of people all over the world. However, we have also witnessed a rise in economic inequality around the world during the same period. It is well known that income inequality in advanced democracies has increased since the 1980s, while several major emerging economies, including, notably, China, also experienced a rise in inequality (Dervis and Qureshi 2017; Qureshi 2017). As Piketty’s influential book (2014) illustrates, while most advanced economies saw income inequality rise since 1980s, the largest increase was in the US, followed by other liberal market economies (LMEs) or Anglo-Saxon countries. Rising inequality, especially in the US and continental Europe, has led to discontentment and fragmentation (Tiberghien et al. 2018). That discontentment and fragmentation has fuelled populists from both extremes of the political spectrum and spurred calls for trade barriers and limits on immigration in the US and some European countries.

Several factors have contributed to the rise of within-country inequality, including globalization, technological change favoring higher-level skills and capital, structural changes in labor markets, the rising importance of finance, and the emergence of winner-take-all markets and politics (Hacker and Pierson 2010; Brian 2015; Lakner and Milanovic 2013; Milanovic 2016).
Although much economic literature has paid scant attention to political variables that affect economic inequality, inequality is an “outcome of social and political struggles” (Milanovic 2016, 86) and a “political phenomenon” (Bartels 2008, 3). This is because any market system is embedded in a larger political system. After all, as Easton’s frequently cited definition illustrates, politics are the “authoritarian allocation of values” (Easton 1957). This is why the comparative political economy literature has focused on distributive outcomes, unlike much of the economic literature (see, for example, Rueda and Pontusson 2000; Kenworthy and Pontusson 2005; Rueda 2007; Bartels 2008; Mosimann and Pontusson 2017).

Again, the overall increase in inequality can be explained by the common factors like globalization, de-industrialization, technological development, and the decline of labor unions. However, on the other hand, the differences of economic inequality among different countries should be explained by domestic political institutional factors, such as differences in regime types, electoral institutions, government partisanship, or labor market institutions.

In turn, the recent experience of advanced democracies has proven that democracy, by itself, has failed to reduce inequality, although there are theoretical reasons why democracy is expected to increase redistribution and reduce inequality. This theoretical expectation may fail to be realized when a democracy is captured by certain segments of the population or when a democracy is not mature enough. However, the empirical findings are still mixed.
In addition, while advanced democracies have both upward trends in level of inequality and democracy, middle-income countries have variations in both.

Therefore, it is worth testing the effect of democracy and globalization simultaneously on emerging or middle-income countries. Although globalization has contributed to the rise of within country inequality in advanced economies, it is still not clear if globalization itself or different dimensions of globalization have had the same effect on middle-income countries. According to Rodrik (1999) and Milanovic (2016), the middle class in the emerging economies has been a big winner in the globalized world. Then, is economic globalization responsible for the increase in within country economic inequality in middle-income countries too?

Therefore, this study examines the cases of middle-income countries in order to investigate the nexus among democracy, globalization, and economic inequality. I consider these to be ideal cases for measuring the effect of globalization and democratization simultaneously.

Following recent studies, I hypothesize that globalization is associated with increased inequality. I also hypothesize that democracy does not have the expected effect on economic inequality that previous theoretical or empirical discussions have posited (Huber and Stephens 2001; Swank 2005), which are based on the experiences of advanced industrial democracies. This existing scholarly discussion suggests that redistributive policies of democratic governments are one of the main mechanisms by which democracies lower income inequality. However, I suggest that this may not be the case in middle-
income countries mainly because, for many reasons, the poor in new democracies seldom hold sufficient resources to have an effective voice. Also, many emerging countries lack the intermediate variables that make a government reduce economic inequality. For example, partisan theory suggests that parties to the left of center have a strong incentive to respond to the demand for more social protection because labor is their core constituency, and strong unions render left-leaning governments more prone to respond to globalization by increasing social protections. To the contrary, since many middle-income countries do not have established left-right politics, this formula may not work.

However, I also hypothesize that domestic political variables like government partisanship and party politics matter once the democracy is consolidated in middle-income countries. My logic behind this hypothesis is that globalization does not only increase competition between nation states, but it also increases market inequality. Increased inequality has generated greater demand for traditional interventionist policies, which some responsive governments and political parties would supply. Therefore, competitiveness and the macroeconomic constraints associated with capital markets do not necessarily reduce the room for government efforts to reduce inequality.

I argue, along the lines of much comparative political economy literature, that domestic factors such as government partisanship and party politics are still important in redistributive outcomes. In addition, evidence from my case study of South Korea illustrates that democracy does have redistributive effects, but it needs intermediate channels such as programmatic political parties. This is
coherence with existing theoretical expectations, despite some conditions are necessary. A democratic government, especially a government that represents the low and middle class, is expected to make more redistributive efforts when the majority of citizens support redistributive policies. However, this requires established left-right politics and programmatic political parties. I argue that a new democracy needs sufficient time to fulfill these conditions.

The thesis is structured in the following way. Section 2 introduces the research method. Section 3 outlines the debate surrounding the implication of globalization and democracy on inequality in the world. Section 4 introduces the empirical results from quantitative analysis and its implications. Section 5 investigates the case of Korea. And the last section summarizes the results and reveals the limitations of this thesis, suggesting some directions for future research.
2. Research Method

In order to test the theoretical arguments outlined above, this study relies on a mixed methods approach in which quantitative and qualitative analyses complement each other, enhancing the strength of my argument. I utilize large-N cross-national time-series models for mid-income countries from 1975-2005. This time frame is ideal, since we have witnessed waves of democratizations, democratic consolidations, and backsliding toward authoritarianism in middle-income countries in the given time frame.

Also, it is more beneficial to focus on a sample of middle-income countries, rather than including poor countries. This is because it has been previously argued that poor democratic countries perform much more poorly than relatively wealthy democracies. One of the main reasons for this may be that they score significantly worse than other democracies on all governance dimensions, such as rule of law, corruption, and bureaucratic quality. There is almost no difference between poor democracies and poor non-democracies with regard to such indicators (Keefer 2009). Therefore, if poor countries are included, it is possible to underestimate the effect of democracy on income inequality.

Cross-national time-series analysis is the most desirable study design because the method takes into account both cross-sectional and longitudinal variation. In addition, this approach has the advantage of allowing me to extend my models and include more variables. However, while cross-national time-
series analysis enables researchers to confirm the existence and pattern of systematic relationships between variables of interest across different contexts, there are also some limitations to using this method. It can only establish correlations between independent and dependent variables, rather than establish causation. Therefore, after testing hypotheses by using statistical analyses, this thesis uses qualitative evidence from the case study on Korea to better understand the complex causal relationships.

Methodologically, my study is distinctive in two ways. First, I use mixed method that includes quantitative analyses and a qualitative case study on Korea. Second, I improve on previous studies by including more extensive pooled time-series data for post-tax family income inequality. I conduct large-N analysis by using recently available data.
3. Theoretical Review

3.1 Globalization and inequality

Globalization has been the dominant economic phenomenon of the last 30 years. Within-country inequality has also increased significantly in many countries during this period. Thus, it is natural to ask whether there is a connection between the two. To what extent can the increase in inequality be explained by globalization?

Existing literature explains that the effects of globalization have been different in societies at different levels of economic development. As many scholarly works (Garrett 1998; Lakner and Milanovic 2013; Milanovic 2016) illustrate, greater global integration is associated with increasing inequality in most developed countries. Many emerging countries showed a similar pattern, while the picture is more mixed more in the developing world.

According to standard trade theory (most notably, Stolper-Samuelson theorem), because free trade enhances many factors for production, the capital owners and skilled workers in advanced industrial countries and unskilled workers in less developed countries would all benefit from free trade. In a similar vein, financial liberalization is also expected to increase income inequality in advanced industrial countries, mainly owing to capital outflow. Furthermore, capital mobility affects the room for government maneuvering in reducing income
inequality via taxation and redistributive policies, because financial liberalization and capital mobility put pressure on the government to pursue an expansive fiscal policy.

To the contrary, it is expected to benefit unskilled labor in the developing world, because they are an abundant factor (see also Rogowski 1987). In other words, since resource returns are equivalent to marginal productivity, by increasing the productivity of labor, capital flow should increase the wage as well. This would increase labor’s income share and reduce income gaps in developing countries. Garrett (2001) argues that globalization has been beneficial for middle-income countries. Milanovic’s (2016) recent and influential work asserts that there are two winner and two loser groups: while the working class in emerging economies as well as the global super rich have benefitted, the working classes in developed countries and the global poor have seen their incomes stagnate during the last 30 years. Although the globalization has brought greater within-country inequality in many countries, inequality has fallen at a global level (differences between countries), and a global middle class has seen the largest incomes increase in the 1998-2008 period (Milanovic 2016). This is what became known as the “elephant curve” because of its shape.\(^1\)

However, empirical findings are still mixed. Smeeding (2002) and Edwards (1997) report that there is no evidence of a negative impact of trade liberalization on inequality. Other studies show that the effect of globalization on inequality depends on sub-components of globalization. For example, Jaumotte et al. (2013) reports that financial globalization is associated with an increase in

\(^1\) The “elephant curve” first appeared in Leckner and Milanovic’s article (2013).
inequality, while trade openness is associated with a decrease in inequality. A number of other empirical studies have found globalization to be systematically associated with the expansion of income inequality—even in developing countries (Lee 2005; Milanovic and Squire 2005; Rudra 2008; Ha 2012).

3.2 Democracy and inequality

There are theoretical reasons for why democracy would be expected to promote a more egalitarian society. The bottom line is that more inclusive political institutions, like democracy, create more inclusive economic institutions, whereas exclusive political institutions, such as authoritarian regime, generate more exclusive economic system.

The first theoretical claim that democracy leads to more egalitarian society can be traced back to Kuznets' model (1955). Kuznets’ curve suggests that the relationship between economic development and income inequality is an inverted U-shaped curve. In his model, the level of inequality has specific patterns—that is, the initial rise and consequent fall.

Some scholars argue that democracy improves an egalitarian distribution of income by focusing on democratic mechanism itself, such as electoral competition and the expansion of political participation. Meltzer and Richard's (1981) seminal study formalized the 'equalizing effect' of democracy. The model suggests that, under the assumption of plurality rule and two-party competition,
as inequality increases the median voter supports more redistribution. Following Meltzer and Richard’s model, Boix (2003), Acemoglu and Robinson (2006), and Acemoglu and his colleagues (2014) have built analytical models of the relationship between democracy and inequality. Describing the distributional results of different political regimes, Boix suggests that equality and democratization are positively related. Acemoglu and Robinson (2006) and Acemoglu and his colleagues (2014) also suggest that democracy favors more redistribution because it represents the interests of the majority of citizens.

To the contrary, there are also some theoretical reasons why democracy may fail to generate more egalitarian society. Institutional weakness is one reason. The poor have less power in the political arena. Also political institutions are less consolidated and left parties and labor unions in middle-income countries are weaker than those in advanced democracies. In this situation, Meltzer and Richard’s assumption would be violated. Obviously this is not only middle-income’s problem. This might be also true in the current case of the US. Many scholars argue that the redistributive role of government is not working well in the US because its democracy is practically captured by economic elites and organized interest groups (Bartels 2008; Hacker and Pierson 2010; Gilens 2012).

Like the theoretical expectations, the empirical literature shows mixed results on the relationship between democracy, redistribution, and inequality. Some studies reported a negative relationship between democracy and inequality. For example, an important study by Rodrik (1999) presented evidence from a panel of countries that democracy is associated with higher real wages
and higher labor share in national income. Lindert (2004) and Persson and Tabellini (2004) provide evidence from OECD countries indicating a linkage between democratization and public spending. Studies by Reuveny and Li (2003) and Rudra (2004; 2008) also support the hypothesis that political democracy reduces income inequality in developing countries.

To the contrary, other studies suggest that there may not be a clear relationship between democracy and inequality. Gradstein and Milanovic (2004) have argued that the cross-national empirical evidence on democracy and inequality is ambiguous. Scheve and Stasavage (2009; 2012) also have claimed that there is little impact of democracy on inequality and policy among OECD countries.
4. Cross-national Time-series Analysis

4.1 Model specification and variables

For the quantitative analyses, I test the hypotheses with pooled time-series cross-sectional data of inequality that cover 35 middle-income countries during the period from 1975 to 2005. Pooled time-series designs may exhibit group specific heteroskedasticity and within-group serial correlation. Although they do not bias the estimated coefficients, these problems tend to produce inefficient and biased standard errors for the coefficients. To reduce the severity of these problems, Beck and Katz (1995; 2011) recommend an ordinary least squares (OLS) regression with the lagged dependent variable using panel-corrected standard errors (PCSEs), which is a standard method in comparative political economy. Therefore, I follow the methodology suggested by Beck and Katz. All explanatory variables are lagged by one year to control for the potential exogenous effects of income inequality.

The dependent variable, Gini coefficient data, was retrieved from the UNU-WIDER World Income Inequality Database (WIID). The WIID allows comparative studies for relatively large numbers of countries and years. As for the effects of globalization, I divide them into two key components, following the contemporary literature of international political economy: Trade and foreign
direct investment (FDI) (see, for example, Swank 2002; Reuveny and Li 2003; Lin and Fu 2016).

The importance of trade and FDI flows to a country differs depending on their magnitude relative to the size of the domestic economy. Accordingly, globalization, in this thesis, is operationalized by the level of trade integration and capital flow as a percentage of gross domestic product (GDP): here, the measure of trade flows is the sum of imports and exports as a share of GDP and FDI as a share of GDP. The globalization data are taken from World Development Indicators.

The measure of Polity is taken from the Polity IV data set. Following Przeworski et al. (2000) and Cheibub et al. (2010), I also apply a dichotomous measure of democracy based on a distinction between authoritarian (coding 0) and democratic (coding 1) regimes. The measure and classification are drawn from Cheibub et al. (2010)’s DD dataset, who use a ‘minimalist’ definition of democracy. For the dichotomous measure, I use DD dataset instead of Polity IV for two reasons. First, setting a cut-off point on Polity IV scale could be arbitrary, and numbers do not really reflect ‘minimalist’ definition of democracy. Second, those theoretical expectations that explain democracy’s redistributive nature focus on electoral mechanism. Therefore, DD dataset is more ideal than using Polity IV to test the relationship.\(^2\)

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\(^2\) Dichotomous measure of democracy does come with its weaknesses. For more scholarly debates on this measurement issue, see Cheibub et al 2009.
For control variables, I include GDP per capita, \((GDP\ per\ capita)^2\), economic growth, age structure, inflation, unemployment rate, and three regional dummies (Asia, Latin America, and post-Communist).

A standard measure of economic development is GDP per capita, and this is why GDP per capita and \((GDP\ per\ capita)^2\) are included. Squared form is used because Kuznet's curve expects curvilinear relationship between economic development and inequality. Economic growth is also included because change of real GDP may reduce income inequality by eliminating poverty. I also control for the age structure and unemployment rate although the anticipated effect is ambiguous.

4.2 The empirical results

My findings are summarized in Tables 1 and 2. First of all, I found that the effects of Democracy (dummy) and also the continuous democracy score, Polity, on income inequality are not statistically significant in any model. These results do not support the conventional wisdom, which expects democracy reduces economic inequality. This will be discussed next section.
Table 1. The Impact of Globalization and Democracy (dummy) on Income Inequality

<table>
<thead>
<tr>
<th></th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade</td>
<td>0.011* (0.020)</td>
<td>0.015** (0.021)</td>
<td></td>
</tr>
<tr>
<td>FDI</td>
<td>0.025* (0.098)</td>
<td></td>
<td>0.027** (0.077)</td>
</tr>
<tr>
<td>Democracy (dummy)</td>
<td>0.311 (1.503)</td>
<td>-1.180 (1.370)</td>
<td>-0.902 (1.383)</td>
</tr>
<tr>
<td>GDP per capita</td>
<td>-19.916 (27.068)</td>
<td>11.253 (26.413)</td>
<td>-16.057 (13.691)</td>
</tr>
<tr>
<td>(GDP per capita)^2</td>
<td>1.401 (1.673)</td>
<td>-0.566 (1.632)</td>
<td>1.138 (0.880)</td>
</tr>
<tr>
<td>Economic growth</td>
<td>0.024* (0.062)</td>
<td>0.023 (0.063)</td>
<td>0.025 (0.059)</td>
</tr>
<tr>
<td>Age Structure</td>
<td>0.095 (0.292)</td>
<td>-0.021 (0.310)</td>
<td>-0.055 (0.285)</td>
</tr>
<tr>
<td>Unemployment</td>
<td>0.048 (0.187)</td>
<td>0.031 (0.210)</td>
<td>0.025 (0.225)</td>
</tr>
<tr>
<td>Asia</td>
<td>-7.263 (6.976)</td>
<td>-4.533 (7.092)</td>
<td>-6.038* (5.053)</td>
</tr>
<tr>
<td>Latin America</td>
<td>4.439* (1.807)</td>
<td>1.002* (1.622)</td>
<td>6.233** (1.720)</td>
</tr>
<tr>
<td>Post-communist</td>
<td>-9.622** (4.862)</td>
<td>-23.911** (3.217)</td>
<td>-20.197*** (3.506)</td>
</tr>
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<td>N of Countries</td>
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<td>35</td>
</tr>
<tr>
<td>Observations</td>
<td>209</td>
<td>212</td>
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</tr>
</tbody>
</table>

*** p<0.01; ** p<0.05; * p<0.10
<Table 2> The Impact of Globalization and Democracy (continuous) on Income Inequality

<table>
<thead>
<tr>
<th></th>
<th>Model 1</th>
<th>Model 2</th>
<th>Model 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade</td>
<td>0.009**</td>
<td>0.013**</td>
<td>0.015*</td>
</tr>
<tr>
<td></td>
<td>(0.023)</td>
<td>(0.020)</td>
<td>(0.005)</td>
</tr>
<tr>
<td>FDI</td>
<td>0.030</td>
<td></td>
<td>0.015*</td>
</tr>
<tr>
<td></td>
<td>(0.105)</td>
<td></td>
<td>(0.005)</td>
</tr>
<tr>
<td>Democracy (Polity)</td>
<td>-0.116 (1.101)</td>
<td>0.201 (0.970)</td>
<td>0.002 (1.003)</td>
</tr>
<tr>
<td>GDP per capita</td>
<td>-10.044 (24.251)</td>
<td>7.721 (25.198)</td>
<td>-15.554 (20.122)</td>
</tr>
<tr>
<td>(GDP per capita)^2</td>
<td>1.107 (1.603)</td>
<td>-0.580 (1.550)</td>
<td>1.282 (1.420)</td>
</tr>
<tr>
<td>Economic growth</td>
<td>0.022* (0.085)</td>
<td>0.027 (0.059)</td>
<td>0.029 (0.068)</td>
</tr>
<tr>
<td>Age Structure</td>
<td>0.065 (0.375)</td>
<td>0.011 (0.391)</td>
<td>0.020 (0.410)</td>
</tr>
<tr>
<td>Unemployment</td>
<td>0.019 (0.191)</td>
<td>0.020 (0.180)</td>
<td>0.023* (0.278)</td>
</tr>
<tr>
<td>Asia</td>
<td>-5.263 (6.466)</td>
<td>-4.998 (6.792)</td>
<td>-5.102* (5.133)</td>
</tr>
<tr>
<td>Latin America</td>
<td>5.003** (1.763)</td>
<td>1.282 (1.882)</td>
<td>6.736* (1.920)</td>
</tr>
<tr>
<td>Post-communist</td>
<td>-10.015** (4.762)</td>
<td>-22.652*** (3.230)</td>
<td>-20.753*** (3.331)</td>
</tr>
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<td>N of Countries</td>
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<tr>
<td>Observations</td>
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<tr>
<td>Adjusted R2</td>
<td>0.9600</td>
<td>0.9593</td>
<td>0.9599</td>
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</tbody>
</table>

*** p<0.01; ** p<0.05; * p<0.10

Unlike democracy, I found that globalization factors, both Trade and FDI, are associated with higher income inequality in most models. These outcomes are in accord with recent studies, although it is contradictory to some theoretical
expectations. Again, standard trade theory suggests that greater trade flows should reduce wage gaps in low and middle-income countries. Similarly, capital openness is also expected to reduce income inequality because financial inflow like FDI increases developing countries' capital stock, which reduces the marginal product of capital but increases the same of labor. However, my findings are inconsistent with that explanation. A causal explanation behind this empirical finding could be based on a ‘skilled vs. unskilled’ explanation. Globalization, either with more open trade or greater FDI, not only increases demand for unskilled workers, but also the demand for the small pool of skilled workers. However, skilled workers’ wages increased more than unskilled workers, and this widens the income inequality gap between the two groups.

As for controls, unlike the theoretical expectation, the effects of levels of economic development and its square are not statistically significant. Other control variables, GDP growth, age structure, and unemployment rate are not statistically significant either. Unemployment is negatively associated with inequality in only one out of six models.

However, it is worth noting that two out of three regional dummies, especially post-Communist, were highly significance. Previous studies (Orenstein 2008; Rose and Viju 2014) have noted that post-communist countries have provided generous provision of fundamental social insurance and services through the government, and the generous social provision is associated with relatively low level of economic inequality among these countries. Although statistically significance is not as high as the post-communist countries, the
results show that the *Latin America* variable is negatively associated with inequality. It has been argued that Latin America has historically has high economic inequality, mainly because of unequal land distribution that has continued since the colonial period (Rueschemeyer et al. 1992; Huber and Stephens 2012). The implication is that high inequality in land distribution increases income inequality in the urban sector by supplying too much unskilled labor (Huber et al. 2006). Thus, one explanation for my results is that globalization has reinforced pre-existing inequality in this region, given the large number of un-skilled workers. However, this needs further investigation. Unlike *Post-Communist* and *Latin America*, the *Asia* variable was not significantly related to inequality in most models. This implies that Asia has higher within-region heterogeneity compare to two other regions, and this makes Asia a more ideal case for a case study.

The quantitative analyses tackle the question of whether globalization is associated with high income inequality. As existing literature has illustrated, my analyses also show that inequality can be explained by the common factors like globalization, de-industrialization, and technological development, although these statistical analysis cannot determine a causal mechanism.

Again, my analyses illustrate that democracy per se is not associated with inequality. This is inconsistent with theoretical expectations of redistributive mechanism in democracies. For now, I would imagine one clue with respect to the causal explanation for why democracy is not related to economic inequality comes from the theoretical discussions on Western European welfare states. The
theoretical assumption of redistributive nature of democracy assumes that there is a political channel and representation for the poor and middle class. However, electoral competition per se may not guarantee greater representation for these two classes. Even in advanced democracies, most notably in the US, the poor sometimes have very limited political power. For poor people to get some benefit from democratic rule, they need ways to make demands; they need the political capacity to achieve their goals. However, the poor in new democracies seldom hold sufficient resources to have a voice in policy decisions. In addition, unlike established democracies, left-right politics are not well established in new democracies, while ethnic politics, clientelism, or regionalism is more common. This will be investigated further in the next section.
5. Case Study – South Korea

Korea experienced a democratic transition in 1987, and has passed Huntington’s two-turnover test (Huntington 1993). The country has since emerged as an economic powerhouse in the global economy with an export-oriented economic structure. Thus, Korea is an ideal case to investigate the nexus between democracy and inequality as well as relationship between globalization and inequality.

Figure 1 Market and disposable Gini coefficient in Korea

Source: KOSIS
Figure 1 presents the trend in income inequality as measured by the market and the disposable Gini coefficient. Income inequality, as measured by the Gini coefficient, has increased over time in Korea. A post-tax and post-transfer 80:20 ratio appears to be very similar to Gini index. In Korea, 80:20 ratio was lowest (4.12) in 1993. Since then, the 80:20 ratio has increased. The number surged after the 1997 financial crisis, reaching a 5.06 in 2010. Between 1989 and 2010, the 80:20 ratio increased by 10%.

As it was outlined in the second section of this study, researchers have examined the influence that democracy has in welfare states on income inequality based on the theory of class struggle. From this perspective, democracy is a polity of the poor produced by historical class struggle (Korpi 1989). The history of Western Europe’s democratization was viewed as a power shift from the rich to the poor. Voting mechanisms in democracy suggest a similar story. Democratization comes with the extension of franchise that usually pulls down the income of the median voter. Again, since a decisive voter determines the policies, a reduction in the median voter’s income increases the likelihood that redistributive policies will be implemented.

Some previous research (Shin 2000; Wong 2004; Peng and Wong 2008) suggests that democratization is an important factor in explaining welfare state development in Korea. This is a plausible hypothesis, as democratization may increase the relative power of the poor. The median voter hypothesis also makes sense as the income of the decisive voter may be pulled down after democratization. There is some historical evidence that democratization
increased the level of welfare generosity, which has redistributional impacts. For example, in 1988, Korea’s National Pension System began to be implemented and health insurance became mandatory for companies with more than five employees in Korea.

Since its democratic transition, Korean governments have made efforts to reduce inequality. As Figure 2 illustrates, democratic governments in Korea have increased welfare spending. Welfare spending, as a share of GDP, was under 3% until 1990s, while it surged after the 1997 financial crisis. Since then, both conservative and liberal governments have increased welfare spending levels. However, as the figure 1 shows, inequality has steadily increased as well.

Figure 2 Public social expenditure (as a percentage of GDP) in Korea

Source: OECD; 2014-2016 is estimated data
Wong (2004) claims that if the authoritarian regimes in Korea and the Republic of China (hereafter, Taiwan) advanced (modest) social policy for economic growth and legitimization prior to democratization, they did so for the electoral calculation in the democratic era, which resulted in the continuity of a productive welfare regime. Democratization in Korea failed to produce programmatic parties. Instead of Western European left-right party politics, regionalism emerged as the most crucial cleavage in electoral politics created by the democratic transition.

The 1997 crisis was certainly a structural breakpoint. This means that an economic crisis is a major driving force behind the surge of economic inequality as well as the expansion of public provision. Public support for welfare increased immediately after the 1997 economic crisis. Economic crisis leads the public to ask for protection and welfare from the government, and democratic governments respond to the public preferences. Interestingly, an economic crisis also produced increased welfare generosity under authoritarian regimes. The 1979 oil shock brought high inflation and unemployment (as can be expected from any economic crisis). The authoritarian government at the time had to worry about social turmoil. Since they did not have election-based legitimacy, they were highly likely to face militant actions in civil society once they lost economic efficiency. As a result, although many social laws and programs were enacted during the 1960s and 1970s, they were not really implemented before 1979 (Park 2007; Yang 2013). Therefore, contrary to democratization argument, it may not necessarily be only the democratic leader that responds to the demands of the
public during times of economic crises. Authoritarian leaders may also have an incentive to provide welfare in order to pre-empt massive strikes, labor mobilization, or any other political turmoil that endangers the regime's legitimacy.

Globalization and economic openness seem to have exerted an impact on the distributive outcomes in Korea. Korea has experienced increasing openness to the world market and global capital since the mid-1990s. Recently, the Korean government has engaged in a series of free trade agreements with several countries. Also, the net inflow of FDI in Korea had steadily increased until 1997. Following the 1997 Asian financial crisis and the corresponding financial liberalization, it skyrocketed. The post-crisis government counted on FDI inflows to supply foreign exchange and capital. The ratio of FDI inflows to gross domestic product (GDP) increased from lower than 1% during 1974–96 to over 2% in 1998–2001 (Park and Mah 2011). To the extent that capital mobility, particularly FDI, exerts negative effects on domestic income inequality, one can expect an association between increasing FDI and growing gaps in distributive outcomes in Korea.

Then why did democratic governments in Korea fail to respond to growing inequality? We may want to pay attention to how domestic institutions work in Korea rather than focusing on democratization per se.

First, power resource theory (Korpi 1983; Bradley et al. 2003) provides an important insight on this issue. This tradition of scholarship views trade unions and parties of the left, representing the interests of the working class, as the champions of the welfare state. Western European politics perform a violet duet,
with its mixture of left parties and right parties. However, like Japan and Taiwan, Korean politics is composed mainly of conservative and center parties. The experience of advanced industrial countries suggests that partisan politics and the underlying power balance between social interests still matter. According to this school of thought, left governments can reduce inequality by increasing social provisions (Kenworthy and Pontusson 2005; Rueda 2008). By contrast, in Korea, the functional cleavages around economic interests played a minor role as a basis of party formation or identification in early democratization period (Sachsenroder 1998). Organized labor has been politically and systematically excluded from the socioeconomic coalitions in Korea (Pempel 2002). Korea has the lowest Union density among OECD countries, and the labor force has had marginal impact on the party system.

Also, a growing literature analyses the links between electoral rules, partisan preferences, and partisan effects. Iversen and Soskice (2006) have argued that left-leaning party governments and, therefore, high levels of redistribution, are less likely in majoritarian electoral systems than under proportional representation (PR), because the median voter in a two-party system has a rational incentive to vote for the right. In contrast, the multiparty system that is typical of PR allows for pro-redistribution coalitions of middleclass and lower-class parties. Korea and other Asian democracies have converged on a mixed member majoritarian (MMM) system, which is highly disproportional form because most representatives are elected from local districts and a much smaller ratio from a party list. If the size of redistributive spending tends to depend upon
the result of electoral systems, rising inequality in Korea can be attributed to its electoral system.

Lastly, we may need to revisit assumptions of the median voter theorem. Theories based on democratic voting mechanisms assume that both the poor and the rich vote equally. However, if the poor votes less than the rich, we must reconsider the existing propositions. One can argue that decreasing voter turnout in Korea or other democracies might be related to increasing inequality. The reason behind this speculation is that the poor tend to vote much less than the rich (Franko et al 2016), so the government has no strong incentive to heed the demands and interests of the former. In a similar vein, as Verba et al. (1995)’s study on the US shows, costs of collecting political information and participating in politics are greater for citizens with lower levels of income and education. It is plausible that this leads to lower vote rates and underrepresentation of the poor.

In Korea, the voter turnout rate in presidential elections has decreased. Although the data series is rather short, one can suggest that decreasing voter turnout may be related to increasing inequality, as power resource theory would predict. However, this question needs more empirical investigation.

Nonetheless, the recent development of the welfare states in Korea does suggest several important implications. Korea, Japan, and Taiwan were often classified as the East Asian model, due to their similarities of political economy.

\[\text{Voter turnout in presidential elections decreasedFrom 89.2\% (1987) to 82\% (1992) to 81\% (1997) to 71\% (2002), and down to 63\% (2007), while up to 75.8\% (2012) and to 77.2\% (2017) (National Election Commission of Korea database). The 2017 election recorded the highest voter turnout rate since the presidential election in 1997. However, this might be an exceptional case as the election was held two months after the impeachment of former president Park Geun-Hye.}\]
and cultural background. Within this group, Korea and Taiwan especially resemble each other due to the limited scope of their welfare expenditure levels, a similar temporal development of their respective social policies, and the relative importance that welfare issues have taken in these societies over the past few years, following democratization (Kwon 1997; Lee and Ku 2007). Nonetheless, when we compare the size of the welfare state and specific welfare programs in more recent period, we can observe more diverged patterns.

Figure 3 Public social expenditure (as a percentage of GDP) trends in East Asia, 1990–2016*

Source: OECD and MFRC. *2014-2016 for Korea and 2016 for Taiwan is estimated data. For Japan, 2014-2016 data is not available.
In terms of the size of the welfare states’ social expenditure trends in East Asian countries show diverse trends\(^4\). While Japan and Korea have undertaken a steadily growing trend since the beginning of the 1990s, Taiwan, although showing levels of expenditure generally similar to those of Korea, has kept a more stable pattern of spending. As Figure 3 illustrates, while Korea has undertaken a significantly growing trend since 2000, Taiwan has experienced a retrenchment in welfare spending. As of 2016, Korea spent 10.4% of its GDP on public spending, while Taiwan spent 4.7% (OECD; MFRC).

The general understanding of East Asian politics is that it is fragmented along regional lines; there is a general lack of ideologically left-wing parties, which naturally limits the explicative power of political variables (Gough 2001; Peng and Wong 2008). Nevertheless, when we narrow down the time frame to a more recent period, I suspect that increased political competition and center-left governments, that have historically belonged to the opposition, have played a role in determining levels of social expenditures in recent years.

Figure 1 illustrates not only that both market and disposable Gini index have surged, but government efforts (calculated as a margin between market and disposable Gini) to reduce income inequality have also increased. The market Gini coefficient reflects exactly the extent to which the market creates wage inequality, whereas the disposable (a post-tax and post-transfer) measure takes into account the role of taxation and social transfer policies and programs.

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\(^4\) Although there are critiques of aggregate social spending as a measure for comparing the size and success of welfare states (see, for example, Esping-Andersen 1990; Castles 2009), the amount of money spent on social protection programs has been seen as a central parameter of size of the welfare state.
in shaping the distribution of wages. Therefore, the difference between the pre-tax and pre-transfer measure and the post-tax and post-transfer measures can be interpreted as the government’s redistributive effort to reduce wage gaps between different segments of society.\(^5\) Recently, the political left played an important role in expanding welfare state in Korea. In terms of social policy platforms, it has been argued center-left party in Korea demonstrated some affinity with the social-democratic welfare model, as they articulated enthusiasm for universal coverage\(^6\) of social protection and tax-funded welfare benefits (Kim 2008; Kuhnle 2004).

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\(^5\) This would neither only nor a perfect measurement for government redistributive efforts, because there are other policies (e.g., education policies) that have redistributive implications. In addition, as Piketty (2014) illustrates, measuring the economic inequality by income inequality may underestimate the actual level of inequality, as wealth inequality is generally greater than income inequality. Some studies report that wealth has become even more concentrated in Korea than it is in Europe, while it is not as concentrated as in the US (Lee 2018).

\(^6\) One example would be the ‘universal organic free school lunch program.’ Expanding a universal free lunch program beyond just the ‘proven’ underprivileged, to all Korea’s elementary and middle school students was liberal opposition party’s biggest election promise in late 2000s. This campaign has fuelled debates on ‘universal vs means-test’ welfare, and has made a crucial impact on introduction of other universal welfare programs later years. In this sense, the political left in Korea performed a critical agenda-setting function.
6. Conclusion

This thesis theoretically and empirically evaluates the impact of globalization and democracy on income inequality in middle-income countries. The first finding from the quantitative analysis is that globalization, measured by trade flow and FDI, is strongly associated with higher income inequality in the observed countries.

Another obvious conclusion is that introduction of democracy does not automatically produce more redistributive outcome. This means that redistributive policies must be targeted and worked for specifically. New democracies have often been established in inhospitable conditions that would not allow democratic institutions to work well. Also, as the Korean case illustrates, we often find regionalism, clientelism, or ethnic politics in a new democracy, and redistribution among classes is not a crucial social cleavage under these ‘old politics’. Thus, in this situation, working and lower-middle classes do not have organizations that clearly articulate their class interests and can effectively mobilize the people. In this sense, a democracy may need sufficient time to grow to the extent that the influences of the democratic political institutions would overcome the old politics.

As it is addressed in section 5, what is more important is not the regime type per se, but the domestic political institutions that affect redistributive outcomes. The Korean case illustrates that party politics have recently played an important role in expanding the welfare state, while domestic political institutions
in emerging countries have had less attention than those in advanced democracies.

The ‘compensation hypothesis’ suggests that national governments increase social expenditures in order to protect their citizens against the risks of globalization. The foundation of this thesis could be found in Polany’s *The Great Transformation* (1944). Polany argues that industrialized societies, in the face of increasingly autonomous markets, in turn implement policies to cushion their societies. In a similar vein, Katzenstein’s (1985) seminal study on small European states also implies that exposure to world markets has been a source of political consensus, favouring compensatory domestic policies.

Globalization has been a strong external force that increased economic inequality in many places. Increased inequality has generated greater demand for traditional interventionist policies, which some responsive governments and political parties can supply. My study suggests that domestic political institutions can mitigate the vicious external force.
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