DEMOCRACY, ELITE BIAS, AND FINANCIAL DEVELOPMENT IN LATIN AMERICA


Does democracy induce financial development? There are good theoretical reasons to believe this to be the case, but the evidence adduced to support this claim has been mixed. In this article, the authors posit that only democracies that appeal to the median voter should experience financial development because those democracies have adopted their own constitution after transition, rather than having inherited one from an authoritarian predecessor. The authors empirically test this theory by focusing attention on Latin America, where there have been several reversals and improvements in financial outcomes and where many countries have cycled between regime types. They find robust support for it across different specifications. While popular democracies tend to reform their financial systems, have greater participation in the banking system, increase the supply of credit and reduce its price, and grow their stock markets, elite-biased democracies do not.