Markets, Politics and Constitutions in SPOT Economies*

By

Thomas B. Singh
Researcher II
Institute of Development Studies
University of Guyana

Email: toto_gy@hotmail.com

27 August 2004

Abstract

Small, Poor, and Open developing countries that are in Transition from centralised to market economic systems are prone to interdependent economic and political spaces, with the political domain obtruding onto the economic domain because of the proliferation of non-market allocation issues after the introduction of markets. In this context, an electorate which depends heavily on government can be manipulated by selective public expenditure policies especially when the incumbent is not required to account for its governance performance. Poor governance and failing States that have ultimate expression in a tyranny of the majority become an equilibrium that can only be changed by constitutional reform of the fiscal, parliamentary and electoral systems. The paper presents a proposal for such reform.

*Various versions of this paper were presented at the *5th International Inter-Guianas Conference*, Turkeyen, Guyana, 2002; the *Roundtable on 'The Changing Relationship Between Political Democracy, Social Democracy and the Market,'* Paramaribo, Suriname, 2002; and the *XXXV Annual Monetary Studies Conference*, St. Kitts, 2003. The paper reflects the comments of participants in all these gatherings, and also the comments made by Dr. Tony Weis, formerly a Senior Researcher with the Institute of Development Studies, University of Guyana. The author gratefully acknowledges these contributions, and also the inspiration and intellectual leadership given by Prof. Clive Y. Thomas, Director, IDS, but is alone responsible for all remaining errors.

Markets, Political Democracy and Constitutions in SPOT Economies

By

Thomas B. Singh

Researcher
Institute of Development Studies
University of Guyana

I. INTRODUCTION

> "Economic freedom is an essential requisite for political freedom. By enabling people to cooperate with one another without coercion or central direction, it [i.e., economic freedom] reduces the area over which political power is exercised. In addition, by dispersing power, the free market provides an offset to whatever concentration of political power may arise. The combination of economic and political *power* in the same hands is a recipe for tyranny." Milton and Rose Freidman, *Free to Choose*, p. xvi.

The efficiency properties of the market mechanism are widely appreciated, as are the specific distortions and failures of the market that render it inefficient, and the appropriate form of intervention that will correct for market failures. Indeed, there are even measures of the magnitude of efficiency losses due to market failures and sub-optimal intervention in markets. All these results have been established in the literature that has developed around the study of markets.

But markets do not exist by themselves. Society can be partitioned into economic and political 'spaces;' and the market operates in a space that has an inconstant, vulnerable and sometimes porous boundary with the space within which political power operates. The market space is associated with individual choice over, and voluntary action regarding, economically meaningful objects and issues, while the political space is associated with collective choice and collective action, over objects and issues that are both economically and politically meaningful, that will rarely if ever be consistent with the preferred choices and actions of every individual.

It is precisely because decision-making in markets is exercised over economically meaningful issues while in politics decisions must be made with respect to issues that are both economically and politically meaningful, that the boundary between the spheres of markets and politics is inconstant and vulnerable. Market failure itself usually warrants decision-making in the *political* space about *economically* meaningful issues, from the control of externalities and the provision of public goods, to the regulation of monopolies and the management of natural resources. This domain of 'non-market allocation' exists between markets and that part of the political space that addresses issues and objects that are *politically* meaningful. The non-market space might be large or small and it may decrease or increase, but if it increased it would tend to do so at the expense of markets. Thus, in developed market economies with established political democracies there are well-defined rules governing the manner in which political power is exercised over non-market issues.[1]

In contrast, in a large number of (SPOT) economies characterised by *Smallness*, *Poverty*, *Openness*, and *Transition* from centralised to decentralised economic systems, there are natural reasons for the mechanisms governing non-market allocation to be informal and rule-less, if not whimsical.[2] Before the introduction of the market mechanism in SPOT economies, all issues and magnitudes, including the economically meaningful ones, were determined in the political space. The very idea of externalities, which are spill-over effects onto third party economic agents beyond the relevant *markets*, would have been meaningless; pollution would have been a technical and even a political phenomenon, not an economic one; and in the formal sector private goods would have been produced and allocated by the public sector so that individual choice itself would have been subject to collective choice. Indeed, there would have only been one formal space, the political one, with the balance of society occupying the large and growing informal sector-space in which individual choice with regard to private goods would have been illegal.

In this context, the adoption of the market system led to the rapid emergence of non-market issues, not so much because of the technical realities such as monopolies, pollution and public goods (which had at any rate existed before the market system was adopted), but because of the emergence of markets that transformed these technical issues into economic ones as well. Moreover, if there was rapid economic growth the magnitude and range of non-market issues would have been even more extensive, though the fundamental economic structure of the non-market issues would have been fairly standard. Thus, in the case of externalities, the structure was essentially that of rational economic agents interacting in markets that were incomplete and with property rights that were ill-defined, but the externalities were extensive because the rational economic agents were also impoverished, marketisation was incomplete and property rights were being drastically re-defined.

The proliferation of non-market issues was also associated with a lack of formal mechanisms and regulatory institutions for dealing with them, and even when such mechanisms and institutions were created they were invariably sucked into the political space by dubious procedures that reserved key positions for political appointees, and by the adoption of technical, command-and-control, regulations rather than incentive compatible ones. Additionally, even in the economic domain only a limited number of economic magnitudes were wholly determined in the market: Though the prices and quantities of most private goods were determined in markets, and the process of privatisation ensured that the public sector was no longer involved in the provision of private goods, the market was governed by monetary, fiscal and exchange rate policies, which in turn were determined in the political domain.

---

[1] For example, the very number of telephone calls a government contractor can make to private sector companies is subject to specific limits, even when that contractor is doing work for a regulatory agency such as the US Environmental Protection Agency.

[2] Though this article will not deal with **social capital**, it is important to point out that there is a role for social capital institutions, developed in the pre-market era, in dealing with non-market phenomena. This article only looks at the limits that should be placed on the potential encroachment of the political space on the economic one.

Either because of the emergence of non-market issues and the lack of market-based regulatory mechanisms and institutions, or because of a psychological affinity to politics (or both), the non-market space essentially became part of the political space and the boundary between emerging markets and politics in SPOT economies was necessarily weak. Of course it was easy for non-market issues to become indistinguishable from politics because the enforcement of regulations, especially if they did not rely on market incentives, must involve the state's coercive powers. On the demand side, polluters, monopolists and the beneficiaries of local public goods would have wanted the coercive dispersal to all of society of the costs associated with these activities - costs that would have otherwise been internalised had there been appropriately designed mechanisms and institutions for determining non-market allocation. If command-and-control regulations and technical standards were applied in an environment in which the state enjoyed limitless powers, the co-option of non-market issues into the political space would have been complete.

The weakness of the boundary between markets and politics makes markets vulnerable to encroachment by politics. In the political space there is necessarily a degree of involuntariness and coercion that accompanies collective decision making processes because such processes are incapable of accommodating the preferences of each individual in society and must therefore impose the will of some fraction of the citizenry on the entire society. Because markets coordinate individuals' voluntary choices while politics involves persuasion or coercion, there will be a tendency for the political domain to encroach on the economic one: The voluntariness of the market domain can be abrogated by coercive action but the exercise of political power will not usually be limited on a voluntary basis. In other words, there is a 'gravity' that pulls the collective choice domain onto the domain of individual choice, and not the other way. Indeed, economic freedom does have the potential to 'reduce the area over which political power is exercised' especially if there are Friedmans to conduct an ideological crusade on behalf of markets, but it will only be allowed to do so if there are *constitutions* that sufficiently limit the scope and degree of political power, especially over non-market issues such as the provision of public goods, the control of externalities and the regulation of monopolies.

This paper is about constitutional mechanisms that could be adopted to limit the encroachment of politics on economics. It pays specific attention to mechanisms that would limit the exercise of political power in the determination of market and non-market issues (particularly the provision of local public goods), and recognises that the opportunity for political power to obtrude on markets is supported by strong incentives when an incumbent can use its (unlimited) powers over the allocation of market and non-market goods and services to secure repeated re-election at the polls. Section II of the paper indicates how smallness, poverty, open-ness and transition-related phenomena create both the opportunities and the incentives for incumbents to use political power to alter market and non-market outcomes and thereby to manipulate the electorate in a manner that will ensure their re-election on a repeated basis. Such incentives and opportunities are abundant when the spaces occupied by politics and markets overlap, or when politics and markets are interdependent. Section III discusses the social choice theoretic issues involved in the hypothesis of overlapping markets and politics and it suggests that it is this overlapping that makes SPOT economies logically 'amenable' to a tyranny of the majority, which is the ultimate perversity in the tendency for politics to overwhelm markets, for coercive political power to diminish economic freedom. Section IV examines the constitutional issues that must be addressed by SPOT economies if the interdependence of markets and politics, and therefore the potential for a tyranny of the majority, were to be minimised. Section V attempts to operationalise these constitutional desiderata in a 'political economics' proposal that would limit the extent to which political power can be exercised over non-market issues in the manipulation of the electorate. A conclusion follows in Section VI.

II. INCENTIVES AND OPPORTUNITIES FOR POLITICAL POWER TO DOMINATE MARKETS

This section identifies how smallness, poverty, open-ness and transition or 'change' create the incentives and the opportunities for the political space to obtrude onto the functioning of markets and for non-market allocation in particular to be subject wholly to the exercise of political power, or in short-hand, for markets and politics to overlap. The relevant features of SPOTs are presented to support the view that there is a fundamental interdependence of the domains of private and collective choice, of the domains of markets and politics, of material resources and power. This fundamental interdependence implies that the economic coordination mechanism in SPOT economies, the mechanism that resolves the three fundamental problems of economics ("what is to be produced, how, and for whom"), is often 'political' in character; and that the social choice mechanism of aggregating preferences is also vulnerable to manipulation by activities in the economic domain of the economy.

Smallness

Smallness contributes to the fundamental interdependence of politics and markets in different ways and for different reasons. At the most general level, the combination of small populations and a small number of economic agents (i.e., small markets), a limited range of domestic production, and monopolistic structures given the small numbers of economic agents, ensures that the individual has little 'say' even in matters of a purely economic nature. The economic literature would actually attribute such 'powerlessness' to atomistic economic agents in large economies, and conversely assume that in a small numbers case, economic agents have more power - particularly to influence price and power. But because a few agents can dominate economic and political life in the absence of any viable competition, markets can more easily be manipulated by political decisions, and the extent of economic power even in the small numbers case is vitiated by the exercise of political power.

Thus, in the small-numbers case political affiliation can readily be attributed to identifiable classes of voter-agents involved in production or consumption. This information can be used to alter the opportunities of a winning fraction of voters and to create the perception that their prospects would be greater with the incumbent than with the opposition. The scope for such action is greater on account of the poverty in which agents live: Because of limited resources and opportunities the producer-voter and the consumer-voter depend more on the 'entitlements' dispensed by the State rather than on the entitlements associated with individual effort, enterprise, and wealth.

Smallness also reduces reliance on market exchange and increases the scope of 'bargaining' or negotiated solutions to the fundamental economic issues in general and to non-market ones in particular, especially if the formal structures and institutions do not exist or have been compromised (as in most transition economies). "Influence" and the 'distribution of influence' often determine who wins a contract, who evades customs and is therefore more competitive, who controls which assets, which businesses survive, who gets relief and support from the State, etc. Similarly, jurisdictions that have influence with central government are in a better bargaining position and can therefore elicit a greater allocation for themselves of public resources for the provision of public goods and the control of externalities, than jurisdictions that lack influence. Influence with politically appointed regulators is also of importance in small economies that invariably have non-competitive market structures in several sectors, from finance and telecommunications to agriculture, natural resource extraction and commodity production. Influence comes from political loyalty to the incumbent. Admittedly, this occurs even in large economies, but in small economies such loyalty is more readily observable, and the importance of loyalty increases because of the opportunities presented by bargaining and negotiation. In turn, bargaining and negotiation replace formal, impersonal, market exchange in small economies because the latter involves greater transactions costs than bargaining among persons who know each other.

The 'co-mingling" of the legislative, executive, and judicial branches of government often occurs in the context of a small number of agents. In particular, the public service becomes subordinate to the political authority and all economic outcomes that depend on the public service become vulnerable to the arbitrary exercise of political power. Smallness might also be associated with a reduction in the demand for formal accountability in both the private and the public sectors. To the extent that this is so, discretion will supplant rules, creating the opportunity for the incumbent to manipulate the electorate by exercising political power in the market.

These factors taken together imply that in small economies, the distribution of *power* may determine *economic* outcomes moreso than in large economies. They also imply a manipulable electorate, given heavy dependence on government and the importance of influence in the economy. Smallness also enhances the ability of agents to act strategically in the political domain to enhance their prospects in the economic one; and *vice versa,* to act strategically in the economic domain to ensure a particular outcome in the political one.

Poverty

Poverty is also associated with (either as cause or effect of) the interdependence of politics and markets in SPOT economies. Generally, in poor economies there is a greater dependence on state provided goods and services for the well-being of consumers and the competitiveness of producers, than is the case in wealthy countries. In particular, most local public goods must be provided centrally because local beneficiaries do not enjoy high income levels to finance such local public goods either by local taxes or by collective action and cost-sharing of a more voluntary nature. The electorate is therefore more vulnerable to manipulation by discretionary spending on local public goods by the central government. National revenues, be they tax contributions, public debt borrowed either from domestic or foreign savers, foreign loans, customs duties, are routinely used to provide local public goods. There is a great risk in SPOTs, because these countries are both poor *and* small, that national resources will be used to provide local public goods to communities which are known to support the elected officials.

Voters in SPOT economies have short time horizons or high 'rates of time preferences' either as the cause or the effect of poverty, or both. In choosing governments and elected officials, voter-agents in SPOTs are required to evaluate the effect of candidates' policy proposals on livelihoods but this evaluation is clearly a function of the time horizon of the electorate, and this in turn depends on the ability of the electorate to make 'forecasts' of these effects, to interpret the credibility of policies and proposals, etc. Voting mechanisms are known to depend crucially on the ability of the electorate to evaluate the *alternative* platforms that are presented to them by candidates. The high rate of time preference in SPOT economies may itself doom the voters to elect a government that promotes only short-term poverty palliation rather than long term poverty reduction and development. Populist policies along with poverty might become the equilibrium, precisely because political power can affect short term economic outcomes for the poor through appropriate re-distribution policies.

Associated with high levels of poverty-induced government expenditure are relatively high taxes, tariffs and significant bilateral aid. The potential for corruption and even criminality in the use of these resources increases because the agent with responsibility for spending (i.e., the government in recipient countries) is entrusted with significant resources that it can use to influence market and non-market outcomes in a manner that will be more in its interest than in the interest of the electorate. The market system's incentive structure is rendered meaningless as resource allocation is governed by rent-seeking behaviour that follows politically determined priorities.

Clearly, poverty-induced 'maximilist' states do more than protect property rights, correct for market failures, redress inequities and determine macroeconomic policy. Greater bureaucracy and high transactions costs are associated with this 'high intensity' government. With the increased scope for both market failure and government failure, political patronage can take the form of the selective reduction of transactions costs and mitigation of market and government failures to the economic benefit of supporters of the incumbent.

These factors taken together imply that in poor economies the well-being of the economic agent-voter and of communities can be readily influenced by actions in the political domain, and similarly, that the incumbent can increase its opportunities for remaining in power by manipulating the poor by appropriate action in the economic domain.

Open-ness

The open-ness of SPOT economies intensifies the fundamental interdependence of politics and markets that is associated with smallness and poverty. Because of globalisation firms in SPOT economies become more vulnerable to imports and domestic investors are forced to compete with foreign investors. By a process of self-selection only those economic agents that support the incumbent are allowed to survive the uncompromising world of global competition, and conversely, the survivors reciprocate with loyalty to the incumbent.

Thus, in a globalised world tariffs and subsidies, selectively applied, can enhance the prospects of some industries at the expense of others. Invariably the choice of industries to support is governed by political considerations. Similarly, the evasion of domestic taxes and customs duties (as long as they remain) becomes more important for the survival of local companies, but again, the decision to prosecute tax-evaders might generally be governed by political considerations. The economic domain ceases to operate on the basis of consist and predictable rules as officials in the tax and customs authorities, and even in the judiciary and the executive, become pawns in the game of survival of the least fit and the most inefficient.

Even foreign investors depend on favours granted by the political authorities for economic space. Because of the high explicit and implicit taxes in SPOT economies, foreign investment must be wooed by the discretionary allocation of tax holidays, exemption from regulations, and other inducements. In return, foreign investors extend[3] financial favours to the authorities in the form of employment, board membership, and outright payments. Kick-backs become more common and widespread as the prospect of economic gain leads foreign investors to make overtures to the political authorities and to politically appointed civil servants. Invariably the foreign investment is absorbed into the fundamental interdependence of market and politics.

This fundamental interdependence also affects the market for labour and other factors. Labour supply is generally sensitive to the fiscal regime, decreasing when taxes on labour income increase. But political considerations often determine the structure of taxes in SPOT economies, and this makes individual choice with respect to labour supply vulnerable to the collective will. If the collective decision framework only reflects the will of the majority, and if the majority favours low income taxes on say agricultural labour but high income taxes on say professional labour, this majority preference might well be reflected in the tax structure. The majority will, with regard to after-tax (disposable) labour income, might even require low incomes and high taxes on professionals in the health and education sectors. To the extent that this is so, a country might lose its skilled teachers and nurses to migration because of political considerations because labour usually migrates to regions where its after-tax income is greatest. Of course the argument can apply to other factors of production. Savings for example, if they are taxed too highly, will migrate via capital flight. Opportunities for factor migration are myriad in the globalised economy.

Transition

Finally, economies that are in transition from centrally planned economic systems to ones that rely more heavily on the market mechanism have increased opportunities and incentives for politics to dominate markets. As mentioned earlier, the emergence of markets has led to the emergence and proliferation of non-market issues for the allocation of which SPOT economies are ill-equipped. More generally, the regulatory capacity of the state after the command-and-control era is so deficient that monopolists (even artificial ones in basic utilities), pollution-generating producers, natural resource-based producers, and other industries/professions that are characterised by market failures and information asymmetries (insurance, doctors, lawyers, etc.), are all virtually free to act in their own interests, without 'fairly' considering the welfare of third party current and future consumer-voters. The competitive advantage is usually granted to those agent-voters with influence in the

[3]This is done either as an act of reciprocity, or as a rational act in which consideration is given by the foreign investor in response to an offer by the political authorities, thereby increasing the chances that the foreign investor will not in the future become a target for (say) nationalisation.

political domain because such influence can secure reduced regulatory costs for the generators of externalities. Similarly, only those consumers and jurisdictions or communities with influence can benefit from the control of externalities and the provision of local public goods.
Economies in transition are required to privatise state owned entities (SOEs) to increase the size of the private sector and to enhance the operation of markets. Privatisation of SOEs leads to a certain distribution of major assets in the small, poor, economy. Selective, rather than transparent and equitable, privatisation will ensure that ownership of former state assets is transferred to private producers who either have a claim on the incumbent government or who will be obligated to the incumbent or both. Moreover, ownership of assets at the 'beginning' of the new market system essentially defines the distribution of 'initial endowments' in the economy and, by the logic of that market system, the 'final allocation.' The government that has oversight of the privatisation process can influence the structure and distribution of economic opportunities for years to come, and if the privatised entities simply become private monopolies the government can extend political patronage selectively to the new owners by limiting favourable regulatory treatment to those owners who support it.

At the political level, in transition economies that are moving from a monolithic executive, legislative and judicial government to one that involves a separation of powers, there is a period of 'thrust and parry' and of 'learning by doing' during which officials in revamped or 'revamping' institutions can violate codes of conduct and procedure with an impunity that is impossible in established democracies. This also allows the political domain to interfere with the working of markets, though with the passage of time the institutions might begin to operate more normally. Of course, it is also possible that political interference in markets might become the equilibrium.

All of the above features of SPOT economies render markets subservient to politics and therefore provide a clear case for limiting the exercise of political power in market and non-market allocation processes. To the extent that this is not done the cultivation of a tyranny of the majority by the incumbent is all the more possible because power and influence are important elements of the economic coordination mechanism in SPOT economies. But the very fact that it is possible to create a tyranny of the majority by political action in the economic domain requires a re-examination of the distinction in traditional social choice theory between voting merely as a way of aggregating individual preferences and economic choice merely as a way of satisfying individual preferences. This re-examination is essentially being done in the emerging literature on political economics, as pointed out in the next section.

III. MARKETS AND POLITICS: FROM SOCIAL CHOICE AND PUBLIC CHOICE TO POLITICAL ECONOMICS

In the political economy of established democracies there is usually a well-defined sphere of activities that are within the domain of either markets or politics; and if there are market failures that cannot be resolved by 'absorption into' the political domain, there are well-defined procedures for settling the claims and obligations in this domain of 'non-market' allocation. What is particularly clear in this dichotomous framework is that the institutional devices for reconciling different interests are distinct, that *markets* resolve agents' different and 'individually rational' preferences for private goods while *political processes* (attempt to) aggregate individual preferences into some meaningful and consistent social preference relation in collective choice contexts. In other words, the domains of individual and collective choice are fairly distinct in established democracies. Sen (1970) even demonstrated that the very logical bases of 'rationality' in individual versus social choice contexts were fundamentally irreconcilable.

A natural problem with this formulation is that the reality in established democracies is quite different from this ideal, that markets and politics do overlap. But the extent and the cost of this overlapping are relatively much greater in SPOTs. In other words, while the distinction between the realms of markets and politics is actually a useful assumption in discussing the political economy of established democracies, the reality in SPOTs is so different that the *starting* point of the analysis has to be the intermingling of the domains of markets and politics. Above it was emphasised that in Small, Poor and Open transition (SPOT) economies the economic and political processes are so intertwined that the distribution of income, risks and opportunities achieved by the political system could so fundamentally alter the outcome of agents' interaction in markets - both in the sense of returns and in the sense of avoided costs - that the analysis of the allocation of economic resources and of power could not be accommodated in the traditional discussions of economics and politics. Specifically, in SPOT economies there are not only *market failures* but there are endemic and even strategically deliberate *government failures* that effectively modify the 'structure of rationality' in both markets and politics. In other words, while the substance of rationality remains that of self-interest and the primacy of individual preferences,[4] individuals begin to act strategically in the political domain to enhance their prospects in the economic one; and *vice versa*, to act strategically in the economic domain to ensure a particular outcome in the political one.

Even traditional theory recognises the possibility of strategic behaviour, but that theory generally confines itself to strategic behaviour in either of economics or politics, to enhance prospects in the *corresponding* domain. For the most part therefore, the economic and political domains of society can be discussed separately, largely because the fundamental problems being discussed are themselves logically distinct even for the most integrated social organism. Will it be necessary to develop an entirely new theoretical framework for understanding the interaction of politics and economics in SPOT economies? Fortunately, no. The theory of public goods and of collective or

[4]Even this formulation may be inaccurate. Stigler and Becker (1977) were able to incorporate addictive behaviour, habits and even fashion in an individual utility maximising framework, but in many small, poor countries individuals may instead have what might be called 'communitarian' preferences such that an individual's satisfaction increases with the material and even non-material well-being of a group or a community. Ethnocentric preferences certainly seem to be of this sort, going beyond a simple statement that such preferences violate the assumptions of anonymity and independence. Such preferences might be most clearly seen in voting behaviour in ethnically diverse societies: a voter from a particular ethnic group may well have a greater sense of 'net satisfaction' with a government that is identified with that group, even if that voter's actual economic well-being is compromised by the government's policies. This purely socio-psycho-logical phenomenon may be reinforced by policies that simply create the perception that voters' prospects will be better under 'their' government, but these two things are logically distinct. In other words individuals in small, poor economies may well have *both* von-Neumann-Morgenstern *and* communitarian preferences in voting.

social choice actually derives from the disciplines of economics and political philosophy. It is clear for example that the decision to provide a public good such as 'security' involves the use of scarce resources which have alternative uses - the central concern of positive economic theory; and the manner in which individual preferences are aggregated to determine the level of provision of various public goods for society is clearly a (positive) question of which political system is used to aggregate individual preferences. Similarly, it is well known in public economics that if the political system is of the simple majoritarian sort, the level of provision of the public good will be consistent with the preferences of the median voter; and that if a country is wealthy enough to be able to fully finance the provision of all local public goods from local resources then a decentralised economic/political system in which local governments compete for mobile, local tax-paying residents, may also solve the underlying economic problem of the optimal level of provision of local public goods. But political theory also has much to say about electoral systems and decentralised government.

The recognition that politics and economics as disciplines both had something useful to say about collective decisions was indeed a valuable insight. This insight led to the application of economic theory to the analysis of political institutions and political systems in the theory of public choice. But even in this literature, the realms of political and economic decision-making, of the market and non-market allocation of resources, remained as distinct as assumed in the social choice literature that was axiomatised by Arrow (1963), according to whom:

> In a capitalist democracy there are essentially two methods by which social choices can be made: voting, typically used to make 'political' decisions, and the market mechanism, typically used to make 'economic' decisions. (p. 1)

What Arrow did was to consider whether there were any constitutional processes by which social decisions or choices could be meaningfully and reasonably inferred from and based on individual preferences over social states, because such social decisions inevitably affect individuals, who in turn are the fundamental units of society. But Arrow did not allow any intermingling of political and economic decisions. Instead he asked whether mechanisms existed that would make political decisions compatible with the individualistic economic calculus of voter-agents in society; whether 'individual-preference aggregation' procedures existed that would ensure that public decisions are consistent with the individuals' preferences for the outcome of those public decisions; whether non-market allocation could have the same rationality qualities as market allocation. Note that the context within which this question arose was the contrast provided by the *market*, in which individual preferences (however diverse and conflicting) are fully reconciled by the decentralised price mechanism.

Buchanan and Tullock (1962) extended the Arrovian framework, but again, they too kept the realms of political and economic decision-making distinct. If Arrow studied the 'representability' of individual preferences in public decisions given some reasonable requirements of the constitutional processes that governed the formation of public decision-making bodies, Buchanan and Tullock considered that even public decision-making entities are made up of individuals with distinct and potentially conflicting individual preferences, that individuals in such entities do not necessarily stifle their private interests in determining the public good. In other words, public (e.g. parliamentary) decisions are characterised both by representability problems *vis à vis* individual preferences, and agency problems *because of* individual preferences.

Though Buchanan and Tullock did not give explicit recognition to the interdependencies of the economic and the political realms of decision-making, the focus on agency in public choice and on the behaviour of *homo economicus* in the public decision-making process, allowed them to recognise the possibility of a 'tyranny of the majority' - a political phenomenon that can so fundamentally affect the distribution of income, risks and opportunities (potential income) in an economy that political processes that allow such a phenomenon are bound to alter economic outcomes in otherwise 'neutral' markets. In this Buchanan and Tullock were actually repeating a concern expressed more than a century before by Mill (1947, p. 4):

> The 'people' who exercise the power are not always the same people with those over whom it is exercised; .... The will of the people, moreover, practically means the will of the most numerous or the most active *part* of the people; the majority, or those who succeed in making themselves accepted as the majority; the people, consequently, *may* desire to oppress a part of their number; and precautions are as much needed against this as against any other abuse of power.

A tyranny of the majority is the logical outcome of the tendency for politics to dominate markets and not the consequence of the aforementioned agency problem of individuals in public choice situations. Nonetheless, it was the methodology of economic theory that led naturally to its diagnosis (by Buchanan and Tullock) as occurring when a majority of persons have identical preferences for given social states, or more obviously, given political parties. Arrow had indeed noted this possibility, but only to indicate an instance[5] where his 'impossibility theorem' would not apply: that instance being when the majority of individuals have identical preferences, in which case majority rule would actually secure rational, consistent outcomes based on individual preferences. But if this was a 'good thing' for Arrow, a reprieve from his pessimistic impossibility theorem (that there is no system of social choice based on individual preferences that satisfies the most reasonable criteria), the associated tyranny of the majority in the view of Buchanan (1954, p. 119) deprived the political system of one of its most desirable properties:

> But certainly, majority rule is acceptable in a free society precisely because it allows some sort of jockeying back and forth among alternatives, upon none of which relative unanimity can be obtained. Majority rule encourages such shifting, and it provides the opportunity for any social decision to be altered or reversed at any time by a new and temporary majority grouping.

At this stage, when a tyranny of the majority was recognised as being politically unacceptable even in an individualistic social choice framework, public choice theorists were on the verge of

---

[5]Buchanan (1954, p. 115) points out that there were two other such instances: unanimity and single peaked preferences.

recognising that political and economic decision-making were interdependent, that the outcomes of markets and political processes were not determined dichotomously in the social system. This was too much of a 'quantum leap' for public choice theory to make though, because public choice theory, like the social choice and political theories before it, had to assume away any potential 'income effects' implicit in the political system. Indeed, so bereft of income effects was the literature's discussion of political processes that Arrow (1969) felt that democratic systems themselves did not appear to have room for income redistribution mechanisms. The public choice literature therefore objected to the potential 'tyranny of the majority' in democratic systems but only because of the political and moral problems of such a tyranny: that it would be politically injudicious and morally wrong to consistently exclude the concerns of entrenched minorities in the social system. The public choice literature did not quite consider the efficiency implications of a fundamental interdependence of the economic and political domains - with or without a tyranny of the majority problem.

None of this is to say that the insights of economic theory, social choice, public choice or political science remain incapable of dealing with the interdependence of politics and markets. On the contrary, it is being proposed that the analysis of policies to *cultivate* a tyranny of the majority in SPOT economies must be informed by insights from all of these disciplines. This is precisely what is being attempted in the emerging discipline of 'political economics,' in which writers such as Myerson (2000) and Persson, Torsten, Tabellini, and Trebbi (2001) are examining how political systems and particularly electoral systems might affect economic outcomes both by affecting the conduct of political parties/candidates and the performance of government. By choosing the appropriate electoral, parliamentary and fiscal systems and by appropriate governance practices, the incumbent can actually alter economic outcomes in a manner that a majority of persons will always be ready to re-elect it on a repeated basis.

IV. The Design of Constitutions for SPOT Economies

Constitutions specify *inter-alia* the mechanism for the representation and coverage of individual preferences in collective decision-making, the rules that govern the exercise of political power, and the rights of citizens. What are the elements of constitutional design that might limit the extent to which politics dominates markets, that compensate for the interdependence of politics and markets or render it innocuous, that minimise the likelihood of a tyranny of the majority?

With the potential returns to and opportunity for abusing power being high the choice of an *electoral system* ought to be the most important constitutional question confronting SPOT economies. Clearly, discussions of electoral system choice in SPOTs will go beyond questions of district size, the range of voter choice, the degree of 'representativeness,' and strategy-proofness, that arise in more established democracies. Moreover, even when SPOT economies are confronted by these questions, the character of the questions must invariably be different. In Section II mention was made of the central provision of local public goods and of the budget. These are two issues that require treatments that go beyond the electoral system because they are determined in the *legislature*, after votes have been duly translated into seats. Allusion was made to several other parliamentary decisions that have a more-than-passing bearing on the evolving economies that are being discussed. The system of making decisions in parliament is also a constitutional question that deserves attention in SPOT economies.

The Constitution and Efficiency: The Case for Semi-Proportionality and More Decentralisation
The extent to which markets can be manipulated by politics can be minimised by making elected representatives more accountable to the electorate for collective decisions made on their behalf. Lusthaus, Anderson and Murphy (1996) identify the strategic factors that influence and even determine the performance of research institutions. The performance of government depends on a set of strategic factors similar to those that affect research institutions, including organizational purpose, the resources used by the organization, and the 'external environment' in which the institution does its work. Accountability is related to the last of these strategic factors, and it is important because it allows government to properly take account of voter preferences, and to respond to the demands of the persons who in the first instance elected the representatives. While it is true that opinion polls may achieve this accountability, it is also true that the *electoral system* determines the extent to which elected officials are and remain accountable to voters.

There three types of electoral systems: winner take all systems, semi-proportional systems, and proportional systems. The types of electoral systems are presented in tabular form in the Appendix. In all these electoral systems the electorate chooses representatives to make 'collective decisions' on their behalf. Such systems are invariably characterised by *asymmetric information*: in the absence of direct observation, the elected representative will always have 'more' or 'better' information about the effort level actually expended in representing the interests of his or her constituency than would the members of that constituency. Given a disutility of effort that can incline elected representatives to prefer lower to higher effort levels, the asymmetry of information provides the opportunity for them to 'shirk' and even to misrepresent the interests of their constituencies (for personal gain, for example). Such behaviour is facilitated by the very nature of the legislature that makes it impossible to attribute legislative outcomes to any one representative in the legislature. The student of economics would recognise this to be the classic principal-agent problem in which 'moral hazard' behaviour can occur. The principal agent problem occurs whenever asymmetric information *and* a divergence of objectives or interests characterise the correspondence of the input (in this case 'representation') made by an 'agent,' to the (legislative) outcomes desired by the 'principal' who elects the representatives. Moral hazard refers to the risk in a principal-agent context that the agent will act in his or her own interests, which are in conflict with the principal's interests, but because the principal cannot monitor or observe the action of the agent the latter will claim to have always acted in the best interest of the principal.

The chief virtue of winner take all systems is that they minimise the principal-agent problem by allowing the electorate to monitor the performance of the elected official, and in that sense they are the most efficient of all the electoral systems because the benefits of allowing performance monitoring exceed the costs associated with Duverger's Law that plurality systems induce two-party systems. In contrast, proportional electoral systems maximise the principal-agent problem, thereby maximising the extent to which elected official can act in his or her private interest while claiming to act in the interest of the electorate.

Myerson (2000) points out that just as a producer is prevented from extracting monopoly rents by competition, elected officials may be prevented from violating the rights of the electorate by lowering the barriers to 'democratic competition.' A major barrier to entry is the organisational capacity of established political parties, and in particular the dominance of two parties (and small electoral districts) when plurality rule is used to determine the winner of an election (Duverger's Law). Myerson's argument therefore implies that plurality systems such as first-past-the-post may reduce accountability by increasing the barriers to entry, and conversely that PR systems (and larger electoral districts) increase accountability - which is why persons calling for reform of the electoral system in the United States are advocating a system of proportional representation. Persson, Tabellini and Trebbi (2001) point out that the barriers-to-entry argument does not recognise that winner-take-all plurality systems increase accountability because such systems allow supporters to monitor the performance of their representatives much more easily than do PR systems that hide individual performance in party lists. Because individual performance cannot be observed under list PR systems, shirking and buck-passing (usually to the opposition!) characterise list PR governments. There is invariably a 'Nash equilibrium' of low-effort, poor performance, and blame apportionment under list PR systems.

Persson *et al* (2001) show further that on balance, though PR increases accountability by the barriers-to-entry argument, it associated with more corruption than majoritarian systems which are better at monitoring individual performance. The discussion seems to suggest that a *semi-proportional system* may serve to reduce the inefficiencies due to corruption and poor accountability in SPOTs. The greater the corruption and accountability concerns, the more 'plurality' should be written into the constitution.

Turning now to public goods which can be allocated by the incumbent in a manner that can be used to cultivate a tyranny of the majority, the constitution can limit the scope for this sort of manipulation of the electorate by specifying an appropriate fiscal system. In a well-known paper Samuelson (1954) established that the market system, the 'invisible hand,' will not be able to produce an efficient level of public goods - goods that may be consumed by everyone without diminishing what is available for others to consume. By an efficient level of public goods Samuelson meant that in an economy producing and consuming private goods and a public good, there is some combination of the public good and of the private goods such that no further 'costless' improvement in welfare could be secured by increasing production of the public good available for consumption. The decentralised economic system could not produce efficient levels of public goods; only government could.

In another equally famous paper, Tiebout (1956) argued that if the public goods were of the *local* variety, i.e., goods that may be consumed by all persons in a particular locality without diminishing the availabilities for other consumers in the same locality, a decentralised *system of government* would actually produce the local public goods in an efficient manner. Tiebout replaced competition among individual producers in the market with competition among local governments for attracting residents who will finance the local public goods by paying local taxes.

In SPOT economies, the well-being of consumers and even the competitiveness of producers depend more on state-provided goods and services than is the case in rich countries. But most *local* public goods must be provided *centrally* in SPOTs because local beneficiaries do not enjoy high enough incomes: Financing such local public goods by local taxes is not feasible in SPOT economies. Moreover the Tiebout model of competition among local governments, though it might appear attractive for its potential achievement of an efficient level of drainage and irrigation, garbage collection, city and municipal roads etc, has a fundamental 'efficiency' problem: Most of these local public goods generate externalities for all other jurisdictions in SPOT economies, and local government competition will not be sufficient to attain an efficient level of local public goods in this context.

SPOT economies clearly need both central and local provision of public goods of both varieties. The *constitution* and particularly the electoral system can actually increase the probability that public goods would be provided efficiently in SPOT economies. Again, *semiproprotional* systems that comprise two sets of legislators - one whose legislators regard distinct localities/regions as their constituencies and another whose legislators (might) regard the entire country as their constituency - may offer the political framework that corresponds to the needs of SPOT economies for both the government provision of most (local and global) public goods and the Tiebout model of 'local government competition' in choosing levels of local public goods. This configuration will allow local governments to compete not for residents (who cannot afford to pay for local public goods) but for central government funds.

But if economic coordination in SPOT economies requires that the political system be the most efficient one, the very interdependence of politics and markets also requires that the political system be also the most equitable because the distribution of income clearly depends on the distribution of power and influence in SPOT economies. There is indeed no need to defend the interest in equity in SPOT economies because such economies by definition do not rely only on markets for economic coordination. It is well known that proportional systems give the electoral system greater 'representativeness' than do winner take all systems. Indeed, the fundamental social choice problem of 'grounding' social choice in the preferences of individuals in society, would clearly be more adequately resolved in proportional systems than in plurality systems.

The Constitution and Fairness: The Case for Supermajority Approval of National Budgets

The state in SPOTs must deal with the 'Nozickian' tasks of the *acquisition* of assets[6] not previously possessed or owned; the *transfer* of ownership or possession of assets from one person to another person; the *rectification* of any injustice that might be associated with the acquisition or transfer of ownership rights to assets. The state may also have to deal with the Rawlsian concern with distributive justice. As is well known, Nozick's view of the state emphasises historical or process concerns and requires a minimal state while Rawls' view requires a more interventionist state that

---

[6]It is not clear that Nozick had in mind assets or just 'things' or resources, but economic theory now recognises that well-being is directly related to the ownership rights to assets. An individual's command over assets determines his income. The range of relevant assets is of particular interest in economies such as Guyana, where an important assets may well be 'knowing the right person.' In other words, the endowment and ownership of social capital may be as important as the endowment or ownership of capital and other conventional resources.

is concerned with end-state justice issues. Because politicians and voters may have different views of the role of the state, and because the claims of both historical and end-state justice are 'reasonable' and indeed pressing issues for SPOTs, the constitution might have to resolve the conflicts inherent in the two sets of claims. The constitution will certainly have to indicate the extent to which minority rights are valid and important. Even electoral systems that are not majoritarian might award a majority of the seats to one political party, in which case the potential 'tyranny of the majority' is an ever present threat.

Perceptions are of the first order of importance in the practice of democracy, and it often happens in SPOTs that the incumbent can easily use its capacity to spend to create the perception among voters that their well-being will be greater if they supported the incumbent in future elections. The manipulation of the electorate in this regard may lead to the kind of ethnic voting that makes it impossible for the incumbent to ever lose an election. In turn, this strips the electoral system of one of its most valuable properties, enabling voters to change elected officials by constitutional means. This was the major concern of Buchanan (1954), who recommended *constitutional restraints* on the exercise of majority rule to prevent the tyranny of the majority that would result from the manipulation of the electorate.

A particular instance of such manipulation has been the aforementioned use of national resources to provide local public goods to communities that clearly support the incumbent. The 'poor-ness' and smallness features of SPOTs make them particularly vulnerable to such as use of public resources for voter manipulation. The budget becomes the most important function of parliament because of the potential for voter manipulation. 'Tyranny of the majority' that may seem easily resolved by PR systems become a reality in parliament if a majority of the seats is won by a particular political party.

The budget approval process must therefore be explicitly addressed in the constitution. An appealing solution will be to require that budgets be approved by a qualified majority in parliament. Caplin and Nalebuff (1988) actually recommend a super-majority of 64% to produce a 'social consensus' rather than a liberty-denying majoritarian solution in 'one-dimensional' problems such as the approval of the budget. Alternatively, the budget should be approved in two stages: first by a non-legislative team that is appointed by the legislature and then by the legislature - to check to ensure that the budget is acceptable to the people being represented.

Constitutional choice for SPOT economies will therefore have to address both the electoral system and the rules governing decision making in parliament.

V. A Political Economics Proposal for SPOT Economies

In this section a specific proposal is outlined that limits the extent to which politics can dominate markets, that can indeed compensate for the interdependence of politics and markets or render it innocuous, that will minimise the likelihood of a tyranny of the majority. It draws on the elements of constitutional design outlined in the preceding section, and its point of departure is a recognition that the benefits associated with being in government are significant in SPOT economies, and indeed can increase for the incumbent who deliberately acts to remain in power.

Dixit *et al* (2000) model the transition of power from one political party to another as an exogenous Markov process that determines political parties' right to divide the economic and political spoils associated with being in power. They do note that the assumption of an exogenous transition process 'precludes any linkage between the actions taken by a party when in power and its prospects for remaining in power,'[7] but regard this linkage as incidental to a more fundamental problem, i.e., the contending parties' maximisation of the present discounted value of the utility associated with each period's allocation of the spoils of government by the incumbent.

But the fundamental problem, the 'objective function,' for incumbent parties in SPOT economies is 'remaining in power' or being repeatedly re-elected: The relative magnitude of the economic and political spoils over which government has control in SPOT economies provides the incumbent with an extraordinary incentive to remain in power; and the weakness of the democratic institutions provides the incumbent with every opportunity to manipulate those institutions to ensure that its access to these spoils continues for as long as possible. Moreover, by remaining in power the incumbent will be able to choose policies that will maximise the magnitude of the spoils of government and minimise the extent of any democratic reform that will vitiate its opportunity to remain in power.

The literature recognises the importance of modelling the objective of the contenders for political power. Alesina (1988) modified Downs' (1957) assumption that parties seek to maximise popularity to reflect that parties "may not care only about winning elections per se, but also about the quality of the policies resulting from an election."[8] A central result of the Alesina (1988) model is that if the electoral game is repeated infinitely both parties will choose convergent-cooperative policies as a subgame-perfect (self-enforcing) equilibrium, but Dixit *et al* (2000) point out that in the Alesina (1988) model the likelihood of such cooperation increases as "ruling individuals ... perceive an appreciable chance that their power will come to an end."[9] The idea is that if the incumbent is unsure of remaining in power it will *while in power* be willing to make accommodations and compromises with the opposition so that when the latter is in power it would reciprocate.[10] A corollary of this is that if the incumbent can so design its policies (regarding the distribution of the spoils of power and the nature of democratic reform) that a winning fraction of the electorate perceives that its interests would always be best served by the incumbent, then the incumbent will

---

[7]p. 536.

[8]p. 796.

[9]Dixit *et al*, p. 533.

[10]The literature on cooperative game theory usually points out that such compromises reflect rational and self-interested behaviour on the part of the incumbent, but it fails to explain why the incumbent might expect the opposition to reciprocate when it gains power. The literature on reciprocity explains why such expectations might be justified, and therefore why political compromise might be rational.

be less likely to make compromises with the opposition.

Remaining in power may be achieved either as a dictatorship or as a tyranny of the majority. In many SPOT economies political dictatorships have been replaced by elected but often entrenched majorities that remain in power either because the overwhelming majority of the electorate are the poor who generally prefer populist leaders, or because the overwhelming majority share a common ethnic identity with the incumbent and their political preferences are cultivated by the incumbent to be ethnocentric; *and* because the electorate can be easily be manipulated by judicious government spending to always return the incumbent (or parties whose platforms are similar to that of the incumbent). Whatever the mechanism by which incumbents regain power on a repeated basis, it should be noted that characterising the objective function as 'remaining in power' makes this behaviour a matter of the preferences of contenders for political power in SPOT economies. This may not be the case though, because such behaviour might well be the result of constraints present in the economic, political and institutional environment in SPOT economies. This issue will not be considered in this paper. Indeed, the discussion above alternated between these two formal possibilities, reflecting the implicit view that the division of the spoils of government and the control over the extent of democratic reform are the elements of the *strategy* of the incumbent whose well-being will be maximised by remaining in power.

It should not be surprising that the interdependence of politics and markets in SPOT economies has as its pivot the fiscal budget. That interdependence, which has its ultimate manifestation in a tyranny of the majority, is related to the budget in three ways:

- In general, there is a heavy dependence on government and on government provision of local and national services even of the 'private' sort. In particular, it is normal for SPOTs to use central government revenues to finance local expenditures.

- Often there is a poor, dependent, and fragmented electorate that can be manipulated by judicious government spending into perceiving that the interests of a contrived or cultivated majority would be best served by the incumbent.

- Political systems generally emphasise the representativeness of parliaments rather than the accountability of candidates to the taxpayers who elected them, even though such representation does not necessarily mean a mitigation of the underlying principal-agent problem, i.e., that elected representatives may not act in the best interests of the voters who elected them.

When an electorate depends heavily on government (whose primary goal is re-election), but that government can manipulate the electorate by its expenditure policies without having to account for its governance in the use of public resources, the performance of government will certainly deteriorate. The political economics proposal outlined below makes this configuration its point of departure. Following Tingerbin (1952), we identify *three* solution instruments corresponding to the three budget-related sources of the problem of the interdependence of markets and politics:

- Decentralised government that can simply take the form of 'stronger' local government. In particular, local governments must be allowed to tax the local jurisdictions; and transfers from central government must be made according to well-established and clear guidelines. In the latter case, matching grants should be favoured over lump-sum grants because the former have both income and price effects while the latter only have income effects. As such the former type of financing of local expenditures from central revenues is more efficient than the latter. Decentralised government will reduce the dependence of local jurisdictions on central government, and in instances where such dependence is unavoidable, will reduce the arbitrariness of the relationship between the levels of government.

- Budget approval by a super-majority rather than a simple majority in Parliament. The scope for using taxpayer resources to manipulate the electorate is minimised by this measure.

- A semi-proportional electoral system such as Parallel Mixed Member System. Semi-proportional electoral systems retain the representativeness element in Parliament while adding an accountability element such as found in Single Member District systems.

If the proposed three-point solution is a necessary one however, it should be noted that it is certainly not a sufficient one. In a sense, the three-point solution assumes that government expenditure policies, the electoral system and the system of government will benefit from greater accountability, but the three-point solution only 'supplies' the greater accountability. If preferences are of the communitarian sort there may be no real demand for accountability, in which case the proposed solution will probably add more noise to the prevailing backwardness in SPOT economies.

VI. Conclusion

If an economy is heavily dependent on government; if the electorate can be easily manipulated by 'judicious' government spending; and if the electoral system does not require accountability of the elected representatives who have control over government spending; then it is hardly likely that good governance will be achieved, or that the State will be allowed to give much needed leadership in the quest for enhanced livelihoods. The SPOT economy is therefore caught in a 'poor-governance equilibrium' that requires more than a tweaking of various models of the State's role in economic development for this equilibrium to change. This is not to suggest that development models are to be discarded, but rather to suggest that before any such model is adopted there are more basic problems that must be addressed. These problems are inherent in SPOTs and arise precisely because of the basic features of these economies that create an interdependence in the domains of scarce power and of scarce economic resources. This interdependence, and particularly the tendency for the domain of politics to encroach on the domain of markets, is so fundamental in SPOT economies that the very economic coordination mechanism depends on the design of the constitution. The discussion in this paper proposes as necessary design elements for the constitution, decentralised government, budget approval by a super-majority in the legislature, and a semi-proportional electoral system, without which SPOT economies will always be saddled with 'failing States.'

APPENDIX ON
TYPES OF ELECTORAL SYSTEMS

Electoral System	Members in district	Extent of information on voter preferences	Extent of consideration of voter preferences in social choice	Method of selecting winner	Equity: Basis of translating votes to seats/Representation	Efficiency: Kind of electoral competition/Accountability
			Winner Take All Systems - No representation for fraction of electorate who voted for 'losers'			
First Past the Post (FPTP), Single-member District (SMD) Plurality US, UK, Zimbabwe, Jamaica, Barbados, India Canada, T & T	$n = 1$	Each voter picks single most preferred candidate; preferences are ordinal but incomplete - one preferred over all others.	Candidates are ranked by aggregate of voter preferences; individual voter preferences among candidates lost in aggregation process.	Plurality: candidate with the highest votes wins.	The winning candidate is awarded a seat and there is a one-to-one correspondence between districts and seats; minorities unrepresented.	Individual candidates (supported or presented by parties) vie for district. Winning candidate accountable to 'plurality fraction' of electorate in district who supported her.
Two Round Runoff (TRR) Cuba, France (Plurality), French Guiana, Monaco, Mali, Haiti, Gabon, Chad	$n = 1$	Each voter picks single most preferred candidate; preferences are ordinal but incomplete - one preferred over all others.	Candidates are ranked by aggregate of voter preferences; median voter preference determines outcome; non-median individual voter preferences among candidates lost in aggregation process.	Majority: a runoff election is held between the two top vote-getters. The winner of the runoff/election is the candidate with > 50% of the votes.	The winning candidate is awarded a seat and there is a one-to-one correspondence between districts and seats; minorities unrepresented.	Individual candidates (supported or presented by parties of the two top vote-getters in the first election) vie for district. Winning candidate accountable to majority of electorate in district.

Electoral System	Members in district	Extent of information on voter preferences	Extent of consideration of voter preferences in social choice	Method of selecting winner	Equity: Basis of translating votes to seats/Representation	Efficiency: Kind of electoral competition/Accountability
Instant Runoff Vote (IRV), Alternative Vote (AV) - equivalent to STV with one winner; Coombs Voting Australia, Fiji (plurality), Nauru	$n = 1$	Each voter ranks all candidates; preferences are ordinal and complete.	Individual voter preferences over candidates contribute to outcome of election.	Majority: the candidate ranked highest by > 50% of the voters wins.* Absent an outright majority winner, the candidate with the fewest votes for 1st place (Coombs: most last-placed votes) is dropped, and her votes are transferred to each voter's 2nd preferred candidate, and so on until a majority winner emerges. *The electoral system known as **approval voting** would select the candidate with the highest number of votes (plurality). Approval voting rules are identical to IRV/AV rules in every other respect.	The winning candidate is awarded a seat and there is a one-to-one correspondence between districts and seats; minorities unrepresented. STV/AV selects the most preferred alternative; Coombs selects the one least intolerable to the majority.	Individual candidates (supported or presented by parties) vie for district. Winning candidate accountable to majority of electorate in district.
Block Vote (BV), At Large Voting Bermuda, Kuwait, Palestinian Occupied Territory, Maldives	$n > 1$	Each voter picks her n preferred candidates; preferences are "block-ordinal" and incomplete - n candidates preferred as a block over all others.	Candidates are ranked by aggregate of voter preferences, and individual voter preferences among n candidates contribute to the election outcome.	Plurality: the n candidates with the highest number of votes win the election.	Each of the n winning candidates is awarded a seat; representation for voters who vote for candidates with the largest support; some minority representation possible.	Individual candidates or groups of candidates (supported or presented by parties) vie for district. Individual accountability blurred; block accountability to fuzzy fraction of electorate.

Electoral System	Members in district	Extent of information on voter preferences	Extent of consideration of voter preferences in social choice	Method of selecting winner	Equity: Basis of translating votes to seats/Representation	Efficiency: Kind of electoral competition/Accountability
Semi-proportional systems - No representation for electorate supporting minor parties' candidates; more proportional for larger parties						
Single Non-transferable Vote (SNTV), Limited Vote (LV) STNV: Jordan; Japan (1948-1993, lower house); Taiwan; Vanuatu LV: Spain, Portugal, 19th & 20th centuries	$n > 1$	Each voter picks most preferred candidate (STNV) or candidates (LV). Preferences are ordinal but incomplete - one preferred over all others (STNV); or block-ordinal, constrained and incomplete - a number candidates (fewer than available seats) preferred over all others rejected (LV).	Candidates are ranked by aggregate of voter preferences; individual voter preferences among candidates lost in aggregation process.	Plurality: the n candidates with the highest number of votes win the election .	STNV: Each of the n winning candidates is awarded a seat; candidates winning $1/(n + 1)$ of the votes will win a seat; small minorities unrepresented. LV: Each of the n winning candidates awarded a seat; representation for minorities guaranteed.	Individual candidates or groups of candidates (supported or presented by parties) vie for district. Individual accountability blurred. Under STNV large parties crowd out small parties.

Electoral System	Members in district	Extent of information on voter preferences	Extent of consideration of voter preferences in social choice	Method of selecting winner	Equity: Basis of translating votes to seats/Representation	Efficiency: Kind of electoral competition/Accountability
Parallel Mixed Member (PMM) Cameroon, Croatia, Japan Guinea, Russia, Albania, Lituhania	For one block of seats, $n = 1$; for another block of seats $n > 1$	As in FPTP/SMD or TRR systems for elections for single member districts; as in PR for elections for multiple member districts.	As in FPTP/SMD or TRR systems for elections for single member districts; as in PR for elections for multiple member districts.	In elections for single member districts, plurality/majority. In elections for multi-member districts, proportionality: Each *party* is allocated the same proportion of available seats as the proportion of the total votes cast in its favour.	In elections for single member districts each winning candidate is awarded a seat and there is a one-to-one correspondence between districts and seats; minorities unrepresented. In elections for multi-member districts, parties and not candidates win seats. Particular districts are not represented by particular legislators. Voters supporting party with the plurality of votes get greater representation than supporters of other parties.	As in FPTP/SMD or TRR systems for elections for single member districts; as in PR for elections for multiple member districts.

Electoral System	Members in district	Extent of information on voter preferences	Extent of consideration of voter preferences in social choice	Method of selecting winner	Equity: Basis of translating votes to seats/Representation	Efficiency: Kind of electoral competition/Accountability
			Proportional Systems			
Single Transferable Vote (STV), Preference, Choice Vote, Hare Voting Republic of Ireland, Northern Ireland, Malta, Australia (federal senate; some state legislatures); Suriname (?)	$n > 1$	Each voter ranks all candidates; preferences are ordinal and complete (unless preferences are strategically truncated by voters).	Individual voter preferences over candidates contribute to outcome of election; subject to manipulation by preference truncation; higher voter preference for candidates may hurt them in election (nonmonoticity); no-show paradox possible: candidates may be helped if fewer persons voted for them. Condercet candidate may be defeated.	Candidates with a minimum or 'Hare/Droop/Imperali quota' of votes are awarded seats. Votes in excess of quota (surplus votes) are transferred 'in accordance' with *all* voters' second-choice preferences. Second-round candidates receiving more than the quota are elected, and the surplus redistribution process continues until all seats are filled. If there are more seats to be filled when this process is exhausted (and this could occur in the first round) the candidate with the least votes is eliminated and her votes are transferred to the *corresponding* voters' next preferred candidate.	Each of the n winning candidates is awarded a seat; more 'proportional' representation in legislature because winners' surplus votes and clear losers' votes are not wasted. More minority representation possible.	Individual candidates (supported or presented by parties) vie for district. The manipulability of STV by strategic voting, along with the redistribution process for determining 'winners' all but destroys accountability to the particular electorate responsible for the candidates' election.

Electoral System	Members in district	Extent of information on voter preferences	Extent of consideration of voter preferences in social choice	Method of selecting winner	Equity: Basis of translating votes to seats/Representation	Efficiency: Kind of electoral competition/Accountability
Mixed Member Proportional (MMP), Additional Member System (AMS) Bolivia, Italy, Mexico, West Germany, Venezuela [GUYANA: *Both* blocks elected by Closed List PR]	For one block of seats, $n = 1$; for another block of seats $n > 1$	Each voter votes twice, once for Single Member Districts (SMD) and a second time for Multi-member Districts (MMD), on a double ballot. For SMD ($n = 1$) each voter picks single most preferred *candidate*; preferences are ordinal but incomplete - one preferred, all others rejected. For MMD ($n > 1$) each voter expresses preference for particular *party* list; voters cannot express preferences for candidates in closed list PR but can, in varying degrees, in open list PR and panachage PR.	In single member districts, candidates are ranked by aggregate of voter preferences; individual voter preferences among candidates lost in aggregation process. In multi-member districts, if the seats are contested under closed list PR individual voter preferences only determine which party wins; social choice over candidates is imposed on individual voters by party/list. Individual voter preferences for candidates contribute to a 'decreasing degree' to the outcome if the relevant seats are respectively contested under STV, panachage PR, or open list PR.	Two blocks of seats in legislature to be filled by SMD and MMD elections. SMD block, plurality: candidate with the highest votes wins. The *overall* distribution of seats in the *legislature* (not in MMD block) is determined in the MMD elections according to proportionality. MMD seats are given by the variance (i.e., +/- shortfall) of SMD seats from the MMD-determined overall proportionality. In other words, overall proportionality is achieved in legislature by the sum of SMD seats and MMD seats.	The winning candidate is awarded a seat in the SMD block. To the extent that SMD seat allocation must be made proportional by adding members from the party list the legislature may be more representative but the two blocks or classes of representatives will have different if not conflicting interests.	Electoral competition is between candidates in the SMD block in the legislature with it will be between parties in the MMD block. In the former representatives will be accountable to constituencies while in the latter representatives will be accountable to political parties.

Electoral System	Members in district	Extent of information on voter preferences	Extent of consideration of voter preferences in social choice	Method of selecting winner	Equity: Basis of translating votes to seats/Representation	Efficiency: Kind of electoral competition/Accountability
Closed List PR Guyana, Netherlands Antilles, Brazil, Argentina, Chile, Eritrea, Bosnia	$n > 1$	Voters express preferences for political parties, not for candidates. These preferences are party/block-ordinal, incomplete are both constrained and imposed: - those candidates chosen by the preferred party in a particular & pre-determined order, are *per force* preferred over any other set of candidates put up by other parties.	Candidates are not ranked by voter preferences. Individual voter preferences for individual candidates do not contribute to the outcome of the election.	Hare Quota/Largest Remainder: After parties are awarded seats according to the Hare Quota, some parties will have 'left over' votes and some seats will be unallocated. Parties with the largest remainder votes are allocated the remaining seats. Also Sainte-Lague and D'Hondt formulae.	The number of seats a party wins is proportional to the number of votes cast in that party's favour. Often there are thresholds that prevent parties say <5% of the votes from representing their supporters. Parties, not candidates, represent voters.	Parties vie for one large district, the country. Representatives are chosen by political parties. There is a two-fold principal-agent problem: parties (agents) may not represent voters (principals), and legislators may represent political parties and not the voters who elected the parties. Indeed it is natural for legislators to act in the interest of the political party that selected them, and there really is no 'first order' principal-agent problem here. Representatives are accountable to political parties and political parties are accountable to 'supporters' as against districts.

Electoral System	Members in district	Extent of information on voter preferences	Extent of consideration of voter preferences in social choice	Method of selecting winner	Equity: Basis of translating votes to seats/Representation	Efficiency: Kind of electoral competition/Accountability
Open Party List PR and Open List PR with panachage Finland	$n > 1$	Open List PR: voters can choose from among the candidates on any one party list. Open list with panachage: voters can choose candidates from any party list.				

Source: Compiled by author from Amy, Douglas J. (n.d), Brams, Stephen and P. C. Fishburn (1991), Centre for Voting and Democracy, (n.d.), Cranor, Lorrie, (n.d.), Cretney, Blake, (n.d.), Reilly, Ben (1997) and World Policy Institute, (n.d.).

References

Alesina, Alberto (1988). "Credibility and Policy Convergence in a Two-Party System with Rational Voters," *American Economic Review*, Vo. 78, No. 4, September.

Amy, Douglas J. (n.d). "Types of Voting Systems," at http://www.mtholyoke.edu/acad/polit/damy/BeginningReading/types.htm

Arrow, K. J. (1963). *Social Choice and Individual Values*, Monograph 12, the Cowles Foundation.

Arrow, K. J. (1969). "The Organisation of Economic Activity: Issues Pertinent to the Choice of Market versus Nonmarket Allocation," reprinted in *Readings in Microeconomics*, eds. W. Breit, H. Hochman, and E. Saueracker, Times Mirror/Mosby College Publishing, 1986.

Brams, Stephen and P. C. Fishburn (1991). "Alternative Voting Systems," in L. Sandy Maisel (ed.) *Political Parties and Elections in the United States: An Encyclopedia*. Available at http://bcn.boulder.vo.us/government/approvalvote/altvote.html

Buchanan, J. (1954). "Individual Choice in Voting and the Market," *Journal of Political Economy*, LXII, 334 - 343

Buchanan, J. M. (1954). "Social Choice, Democracy and Free Markets," *Journal of Political Economy*, LXII, 114-123.

Buchanan, J. M. and G. Tullock. (1962). *The Calculus of Consent*, Ann Arbor.

Centre for Voting and Democracy, (n.d.). "Glossary," at http://www.fairvote.org/glossary.htm

Cranor, Lorrie, (n.d.). "Vote Aggregation Methods," based on unpublished PhD Thesis. Available at http://www.ccrc.wustl.edu/~lorracks/dsv/diss/node4.html

Cretney, Blake, (n.d.). "Legislature Election Methods," available at http://condorcet.org/emr/multi.shtml

Dixit, Avinash (2001). "Some Lessons from Transactions Cost Politics for Less Developed Countries," Department of Economics, Princeton University.

Dixit, Avinash, G. Grossman, F. Gul (2000). "The Dynamics of Political Compromise," *Journal of Political Economy*, Vol. 108, No. 3.

Downs, Anthony (1957). *An Economic Theory of Democracy*, New York, Harper & Row.

Lusthaus, Charles, G. Anderson and E.Murphy (1996). *Institutional Assessment: A Framework for Strengthening Organisational Capacity for IDRC's Research Partners*. Downloadable at http://www.idrc.ca/books/focus/771/chap6.html

Mill, J. S. (1947). *On Liberty*, Harlan Davidson Inc. Reprint of 1859 original publication; ed. Alburey Castell.

Myerson, R. B. (2000). "Economic Analysis of Constitutions," *Centre for Mathematical Studies in Economics and Management Science*, Northwestern University, Discussion Paper No. 1291

Persson, Torsten, G. Tabellini, F. Trebbi, (2001). "Electoral Rules and Corruption," *National Bureau of Economic Research* Working Paper No. 8154.

Reilly, Ben (1997). "Open, Closed and Free Lists," *Administration and Cost of Elections Project*, available at http://www.aceproject.org/main/english/es/esg03.htm

Samuelson, P. A. (1954). "The Pure Theory of Public Expenditure," *Review of Economics and Statistics*, 36, 387 - 389.

Sen, A. (1970). "The Impossibility of a Paretian Liberal," *Journal of Political Economy*, Vol. 78, No. 1, 152-157

Stigler, G. and G. Becker (1977). "De Gustibus Non Est Disputandum," reprinted in *Readings in Microeconomics*, eds. W. Breit, H. Hochman, and E. Saueracker, Times Mirror/Mosby College Publishing, 1986.

Tiebout, C. M. (1956). "A Pure Theory of Local Expenditures," *Journal of Political Economy*, 64, 416 - 424.

Tinbergen, J. (1952). *On the Theory of Economic Policy*, Amsterdam, North-Holland.

World Policy Institute, (n.d.). "Types of Electoral Systems," at http://worldpolicy.org/americas/democracy/types.html