Political Economy of Policy Failure and Institutional Reform

A review of the academic literature

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Acknowledgements

We are grateful to the Economic and Social Research Council for proving financial support to our research.

Contents

Introduction

This paper is part of a project on the Political Economy of Growth and Institutional Reform and forms the intellectual backbone of two accompanying papers on the political economy of housing and infrastructure. Its purpose is threefold: first, to review political economy studies focused on the quality of governance and, in particular, on the institutions that mould the policymaking process, thereby influencing the risk of policy failure, i.e. suboptimal policy choices; second, to examine the particular features of the UK Westminster model that amplify the risk of policy failure, which we do by drawing on political science literature on the British constitution, as well as empirical, comparative studies of the British macro polity; third, to investigate the drivers of institutional change. The focus is on the limits and possibilities of institutional reform, and on how institutions evolve, including the conditions for and drivers of institutional change. We bring together insights from multiple strands of institutionalist literature, with an eye on identifying common ground among those traditions.

The first section of the paper concentrates on the domain of individual preferences and interests that feed into the political process (i.e. political representation), and the degree of alignment between individual preferences and interests and policy choices (i.e. policy responsiveness). These are both important aspects of the definition and measurement of quality of governance.

Problems of political representation may arise at two different levels: when only some of those affected by policy decisions have a say in the outcome; and in the way political institutions deal with conflicting sets of preferences and interests. Problems with policy responsiveness have become the main subject of interest of political economy studies. They point towards a variety of possible distortions in the link between voters' preferences and interests and policy decisions, which stem from four key sources: distortions caused by core and swing voters/constituencies; rent seeking; problems of policy credibility/commitment; and information imperfections. The first section of the paper reviews this literature.

Some of the core features of the UK Westminster model shape the policymaking process in ways that amplify the risk of policy failure. Examples include the disproportionate weight of marginal constituencies/voters; the lack of consensus-building approaches in areas of policy where longer-term credibility/commitment, extending beyond one electoral cycle, is crucial for policy effectiveness; and incentives for political parties and legitimate interest groups to use information in ways that damage the quality of the policymaking process. The second section of the paper surveys the political science research that examines these issues.

One important limitation of this literature is that the implications of the recent trend towards electoral fragmentation in the UK are largely absent. The traditional view of the UK political system as a paradigm of strong and stable government, supported by the dominance of two large parties with mass electoral support alternating in power is no longer accurate. The development of multi-party politics and regional political divergences on the back of increasingly-fluid party allegiances represents a radical departure from the standard description of the Westminster model.

The final section of the paper turns to the drivers of institutional change. The traditional account of institutional change evolution is dominated by the idea that long periods of institutional stability are abruptly interrupted by sweeping changes caused by exogenous shocks (typically profound economic and political crises). Another view that has been gaining traction draws attention instead to important patterns of subtle, incremental institutional change, that often add up to fundamental transformations in counterintuitive ways. Some authors have argued that the contemporary evolution of the UK Westminster model includes plenty of cases of institutional change without an overarching political strategy, let alone new constitutional settlements (Flinders, 2010). Alongside the role of crises and of the notion of incremental institutional change, changes in ideas/beliefs (about individual interests and preferences, and how the economy works, including how policies connect to outcomes) is another major piece of the institutional reform puzzle.

Of the three subjects reviewed in this paper, this is the one which academic literature has struggled with the most. We seem to know quite a lot about institutions, but little about how to fix them. Yet, the prize for institutional innovation is high. It has been argued, in fact, that the key to long-term prosperity is 'adaptive efficiency' – namely a society's capacity and flexibility to modify or create institutions as problems evolve.

The political economy of policy failure

Economists and political scientists have made considerable headway in studying how political institutions[1] affect policy decisions and economic outcomes. There is an academic literature dating back more than two centuries that has been focusing on these issues. Although this literature still lacks a cogent organisation and a unified approach, it encompasses sufficient theoretical and empirical contributions to shed light on the quality of governance, and in particular on the institutional drivers of policy failure. It is not our intention to present an exhaustive review of this literature here, but rather to concentrate on its main findings.

Defining and measuring quality of governance are subjects of dispute (e.g. Besley, 2006; Fukuyama, 2013; Coppedge, *et al.*, 2011). Part of the problem is that 'the state, that is, the functioning of executive branches and their bureaucracies, has received relatively little attention in contemporary political science… the overwhelming emphasis in comparative politics has been on democracy, transitions to democracy, human rights, transitional justice, and the like' (Fukuyama, 2013, p.2). Economists, on the other hand, are broadly in agreement about the need to place the idea of 'government failure', in the sense of suboptimal policy choices, alongside the notion of 'market failure' in discussions of government intervention. But, unlike the concept of market failure, there is no agreed definition of government failure in the political economy literature. It is a term that is often used, but rarely defined.

In the standard welfare economics framework, the relevant performance metric for making sense of the quality of governance is the notion of *social welfare* (e.g. Atkinson and Stiglitz, 1980). In this sense, government (or policy) failure consists in policy choices that fail to maximise *social welfare.* The latter requires an aggregation of individual utility levels into a societal measure of well-being through so-called 'social welfare functions'. There is still no

[1] Defined as the underlying rules of economic and political interactions. For more details see Annex 1.

consensus in the literature on the criterion for this aggregation. It features multiple, competing notions of the common good. These are the subject of study of social choice theory, a topic that sits outside the scope of this review.

In this paper we focus instead on aspects of the policymaking process that are likely to be important for the quality of governance and, therefore, the risk of policy failure, irrespective of the specific form of the social welfare function. Two such aspects are how individual preferences and interests are taken into consideration by the political system (i.e. political representation), and the degree of alignment between policy decisions and those preferences and interests (i.e. policy responsiveness) (e.g. Przeworski *et al.*, 1999; Urbinati and Warren, 2008).

With regards to the first question of political representation, problems may arise at two different levels. First, when only some of those affected by policy decisions have a say in the outcome. Some of the most obvious examples of this include decisions which have impacts on future generations, who do not have a say on those decisions since, by definition, they are not part of the current electorate (e.g. Lamy *et al.*, 2013); decisions that constrain the options of future governments;[2] and restrictions imposed by geographical constituencies on the ability of non-residents, who are by definition excluded from the local electorate, to have a say about local policy decisions that affect their interests.[3]

Second, there may be problems in the way political institutions deal with conflicting sets of preferences and interests. Scholars often take the preferences of the median voter as the normative benchmark. It is said to capture the 'most democratic' policy reference, in that it would be preferred to any alternative policy in head-to-head majority-rule voting by all citizens.[4] Yet, there are no guarantees that the preferences of the median voter are a good yardstick of collective interests (Kolm, 2009; Atkinson, 2011; Fleurbaey and Maniquet, 2011).[5]

As for the issue of alignment between policies and the interests of the electorate (i.e. policy responsiveness), a key tenet of representative democracy is that electoral accountability should make policy responsive to individual preferences. In practice, however,

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[2] For example, Persson and Svensson (1989) and Tabellini and Alesina (I990) show that governments have an incentive to run deficits to reduce the policy flexibility of future incumbents. Aghion and Bolton (1990) and Milesi-Ferretti and Spaolore (1994) show that strategic policy choice can also lead to changes in who is elected.

[3] Planning decisions regarding housing developments are an obvious example (see our report *Housing that Works for All: The political economy of housing in England* – one of the components of this research project). Pressure and advocacy groups can mitigate this problem to a certain extent by influencing territory-based votes along non-territorial lines (Dahl 1956, 1971; cf. Mansbridge 2003).

[4] Under certain conditions, policies that cater for the preferences of the median voter are also the predicted result of electoral competition. The 'median voter theorem' (Hotelling, 1929; Black, 1948; Downs, 1957) posits that in direct democracy, with uni-dimensional, single-peaked preferences, two vote-seeking parties will both take the same position at the centre of the distribution of voters' most-preferred positions. Social choice theory – starting with the seminal contribution of Arrow (1952) – has shown that the median voter prediction follows logically only for unidimensional politics. If citizens' preference orderings are not uni-dimensional and are sufficiently diverse, majority rule might not lead to any equilibrium at all. Despite these results, and accusations that the median voter theorem is too simplistic and inappropriate to describe the intricacies of modern democracies (more on this below), a significant number of studies still make use of it, and there is some empirical evidence that supports it (Monroe 1979, 1998; Page & Shapiro 1983; Erikson,
Wright & McIver, 1993; Stimson, MacKuen & Erikson 1995; Erikson, MacKuen & Stimson, 2002).

[5] These are important issues. For example, it is common for studies of the effects of different constitutional arrangements on fiscal outcomes, simply to assume that the median voter is fiscally conservative, so that lower taxes, budgets, and deficits are a good thing. In practice, without more information about social preferences, the welfare implications of these fiscal outcomes are unclear.

this is not always the case, and such exceptions have become the *raison d'être* of a large part of the political economy literature, which points towards a variety of possible distortions in the link between voters' preferences/interests and policy decisions. The field is vast, but it can be sensibly classified into four main categories: distortions caused by core and swing voters/constituencies; rent seeking; problems of policy credibility; and information imperfections.

The theoretical frameworks that underlie these analyses usually assume that voters use the ballot box to select the leaders they think will perform most competently, and to incentivise them to act in accordance with their interests.[6] Politicians are said to be motivated by the desire to retain office and/or by individual/partisan policy preferences. Strategic behaviour is the dominant feature of the interaction between all relevant political actors, i.e. each individual/group is expected to anticipate how others will respond to the actions they take.[7]

One of the standard causes of distortions in policy responsiveness discussed in the literature concerns the influence of core and swing voters. The hypothesis is that politicians might use their control over government resources to gain electoral advantages. They might target spending, in ways that go over and beyond programmatic commitments, to loyal supporters to reward them for voting; to swing voters[8] in an attempt to sway their votes; and to marginal constituencies to preserve a majority in the national legislature.[9]

Related empirical literature is mostly concentrated on the hypothesis that parties may target swing constituencies.[10] For example, Ward and John (1999) estimated that, in the run up to the 1997 election, around £500 million (m) of central government grants were channelled towards English marginal constituencies in excess of what they could have been expected to get on the criteria of social need and population, and around £155m to 'flagship' local authorities. Besley and Preston's (2007) analysis of data from 150 local councils in England from 1973 to 1998 indicates that local policies were more extreme/partisan in constituencies with a higher proportion of core voters, and relatively more moderate in places where there were more swing voters.

Rent seeking is another classic cause of biases in policy responsiveness and one of the most influential in the political economy literature.[11] Special interest groups try to

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[6] The old view was that voting behaviour was purely retrospective, i.e. sanctioning past performance. In the technical jargon, voters (principals) would be simply attempting to reduce the moral hazard of elected representatives (agents), incentivising good behaviour by re-electing high-performing politicians and throwing out poor performers. In the modern view, voters make efforts to estimate the quality and competence of incumbents through their performance in office and a range of other credentials. They use that information to make a judgement on whether to re-elect them or to take chances on an unknown challenger. For relevant empirical evidence see, for example, Besley & Case (1995) and Alt *et al*., 2011.

[7] For example, in an electoral contest, the pay-off to a party, candidate, voter, interest group depends not only on his or her own actions but also on those of political actors.

[8] Swing voters are those who are politically responsive to public spending, material inducements, or campaign spending, because they exhibit low partisanship and/or are poor (Dixit & Londregan) – on the assumption that voters will prefer a party further from their partisan ideal point if that party offers them transfers large enough to compensate their partisan attachment; or because they lack political information and are, therefore, impressionable (Grossman & Helpman) – i.e. they can be easily swayed by material or informational inducements.

[9] Some of the most relevant models of this include Dixit & Londregan (1996), Lindbeck & Weibull (1987), and Cox & McCubbins (1986).

[10] Most of the available data refers to electoral units rather than individual voters.

[11] For a recent, comprehensive review see de Figueiredo & Richter (2014).

influence the policymaking process, tilting policy in their preferred direction (e.g. by offering campaign contributions and strategic information to politicians). It is a ubiquitous explanation of policy failure in the political economy literature,[12] and some of the most recent empirical studies, mostly from the US, are demonstrative of magnitude and sophistication of the phenomenon.

A study of former congressional staffers turned lobbyists in the United States for example, reported a fall in their revenues of about 24% when their previous employer left the Senate – an annual decrease of $182,000 in income for the median lobbyist (Blanes-i-Vidal *et al*., 2011). Analysis of lobbying expenditure by mortgage lenders before the sub-prime crisis revealed that it doubled from $25 million in 2001 to $50 million in 2004; that it was targeted at representatives from congressional districts with high subprime shares; and that it had a tangible effect on their voting patterns on pro-mortgage housing legislation (Mian *et al*., 2010). An influential paper by Gilens and Page (2014) reported that economic elites and organised groups representing business interests have substantial independent impacts on US government policy, while average citizens and mass-based interest groups have little or no independent influence.

There are a few other drivers of distortions to the link between social preferences and policy decisions that have become part of the political economy mainstream. One of these relates to problems of policy credibility/commitment,[13] often linked to time inconsistencies,[14] i.e. instances when politicians or the public face incentives to announce/commit to certain courses of action and later renege on that commitment. There is a vast discussion in academic literature regarding the nature and effects of these problems in the context of monetary policy,[15] but they extend to other policy areas as well. Fiscal policy, for example, is full of dynamic inconsistencies, as are other less obvious areas like foreign policy (Alesina and Stella, 2010). Utility regulation is also subject to problems with some features of time inconsistencies: regulators face incentives to allow consumers to benefit from services generated by private investments in infrastructure but charge a price that does not compensate for sunk, investment costs. Anticipating this behaviour, private investors will be reluctant to commit to such projects (Armstrong, Cowan, and Vickers, 1994; Trillas, 2010).

Information imperfections are the other driver of distortions in policy responsiveness that have become part of the political economy mainstream. The theory is ambiguous in

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[12] Rodrik (2014, p.189) makes this point vividly: 'In most prevailing theories of policy choice, the dominant role is instead played by vested interests – elites, lobbies, and rent-seeking groups which get their way at the expense of the general public. Economists, political scientists, and other social scientists appeal to the power of special interests to explain key puzzles in regulation, international trade, economic growth and development, and many other fields. Why does regulation favour incumbent firms at the expense of consumers or potential entrants? Because bureaucracies can be captured by well-organised "insiders" who can shape regulation in their favour... Why are trade restrictions so rampant despite the well-known gains from trade? Because import tariffs and quotas redistribute incomes to politically powerful business groups and lobbies... Why do political elites not favour growth-promoting policies and institutions? Because growth-suppressing policies, such as weak property rights, excessive regulation, or overvalued currencies provide these elites with access to rents that would disappear otherwise..."

[13] That is, the extent to which individuals believe that policy will be sustained.

[14] Of course, problems of credibility/commitment do not stem exclusively from time inconsistencies, but also from policy and regulatory instability.

[15] See Alesina & Stella (2010) for recent a review. Most of the existing empirical literature that has focused on advanced economies has struggled to find evidence of monetary policy being strategically managed to induce business cycles (Beck, 1987; Leertouwer & Maier, 2001). But some of the most recent studies focusing on the US and Canada, have found evidence of expansionary monetary policy in pre-election periods (Abrams & Iossifov, 2006; Ferris, 2008; Klose, 2012; Funashima, 2013).

some areas,[16] but the prediction that better information about policy choices improves the quality of governance by strengthening electoral accountability, is largely borne out by a range of empirical studies. Research has shown, for example, that better information leads to an increase in voter turnout, higher engagement of voters and incumbents in the political process, and better policy outcomes.[17]

Conversely, information imperfections have been empirically linked to weaknesses in electoral accountability. The main argument is that politicians' desire to impress voters for electoral reasons may conflict with the goal of advancing voters' interests.[18] Alternative hypotheses have been discussed in the literature. One of these hypotheses posits that politicians might anticipate that voters will judge their performance according to a limited number of outcomes for which information is available. This would lead to policies designed to target those outcomes, even when that runs against voters' best interests.[19] An alternative hypothesis sees office-seeking politicians holding privileged information about policies, not disclosing it to preserve their re-election chances, and opting instead to pursue policies designed to impress voters (often against their best interests), 'pandering to popular opinion' in the technical jargon.[20]

Studies of elected judges in the American state of Kansas offer some empirical support to these theories. They compared decisions from judges who face competitive elections to decisions from judges who face non-competitive retention elections. The quality of the decision is largely hidden from the electorate. The risk of letting off a defendant who goes on to commit crimes is thought to weigh heavier on the minds of judges facing competitive elections, since they are expected to be under additional pressures from voters, challengers and the media. These greater incentives to appear tough on crime have been shown to increase the probability of incarceration by between 2.81 and 4% (Gordon and Huber, 2007). Greater media coverage can intensify this effect leading to even harsher sentencing (Lim *et al*., 2010) and the weight of higher sentencing has been shown to fall disproportionately on African-American defendants (Park, 2012).

In the field of regulation, direct election rather than appointment of regulators by elected politicians, has been empirically linked to more 'pro-consumer' regulation in the form of lower prices (Besley and Coate, 2000; Navarro, 1982) .[21] Yet, such policies could also have negative effects on investment decisions, harming consumers' interests in the long run.[22] In a study of gas companies, Troesken (1997) found support for this hypothesis (p.14). 'Local regulators tended to respond to consumer interests, while state regulators

[16] For example, Chapter 3 in Besley (2006).
[17] For example, Besley & Burgess 2002; Alt & Lassen, 2006; Eisensee & Strömberg, 2007; Boeri & Tabellini, 2012; Gentzkow *et al*., 2009; Strömberg, 2004; Snyder & Strömberg, 2010; Calmfors & Wren-Lewis, 2011; Yamamura & Kondoh, 2013.
[18] See Ashworth (2012) for a review.
[19] For example, Daley & Snowberg (2011); Holmström & Milgrom (1991); Lohmann (1998); Ashworth (2005); Ashworth & Buenode Mesquita (2006); and Gelbach (2007)
[20] For example, Scharfstein & Stein (1990); Coate & Morris (1995); Canes-Wrone *et al*. (2001); Maskin & Tirole (2004); and Besley (2006).
[21] Besley & Coate (2000) argued that this result is related to the fact that regulation tends to be bundled with other issues when regulators are appointed; that voters have only one vote to cast; and regulatory issues are usually not salient for most voters. When regulators are elected, their stance on regulation is the only salient issue, which can sharpen incentives for public officials to adopt pro-consumer policies.
[22] The risks associated with regulator populism were in fact an important source of concern in the early years of US utility regulation. Once a utility had sunk its capital, it relied on the regulator to allow them to charge prices that supported an acceptable rate of return.

sympathised more with producer interests. State regulation, moreover, may have acted as a commitment mechanism. With state regulation, producers were assured that they would not be subject to the political whims of local regulators.'

The perverse effects of information imperfections on electoral accountability go beyond the increased risk of policymaking that 'panders to the public' (Healy and Malhotra, 2013). Even when all relevant information is available to voters, they may find it difficult to process all that information and rely instead on cognitive shortcuts. These heuristics often lead people to make optimal decisions, but they can also lead them astray (Kahneman, 2011). Empirical examples abound. The status of the economy in an election year has been found to have a relatively large impact on voting behaviour and elections outcomes (e.g., Kramer 1971, Fair 1978, Tufte 1978, Achen and Bartels 2004, Bartels 2008).[23] Conditions prevailing in the local economy have been shown to influence people's perceptions of the national economy, although the effects reported are quite small. Fuel prices, the housing market, and local unemployment all appear to influence perceptions of national economic conditions (Mondak *et al*. 1996, Books and Prysby 1999, Ansolabehere *et al*. 2012, Reeves and Gimpel, 2012). Finally, there is a small group of studies that have begun to expose how emotions may influence the way voters reward or punish politicians for reasons that have nothing to do with their performance.[24]

There is emerging evidence that these cognitive shortcuts and behavioural patterns have impacts on policymaking. Theories of politically-induced business cycles, for example, posit that incumbents could manipulate fiscal and monetary policy to stimulate the economy prior to an election to increase their chances of re-election. For the most part, their empirical counterparts have been fairly disappointing (Keech, 1995; Drazen, 2000). But some of the most recent studies have found that fiscal deficits tend to be higher in election years in new democracies (Brender and Drazen, 2005) and that, in established democracies, there tends to be a shift from capital to current expenditure, and shifts in spending allocations towards publicly-salient policy areas such as education, transport, and sport and recreation (Brender and Drazen, 2013; Kneebone and McKenzie, 2001; Katsimi and Sarantides, 2012). It has also been reported that, once falls in private investment in the pre-election period are taken into account,[25] evidence of political business cycles becomes stronger (Canes-Wrone and Park, 2012).

The UK Westminster model and policy failure

The literature reviewed in the previous section focuses on problems in political representation and policy responsiveness without allowing for the macro polity, i.e. the macro/constitutional configuration of the political system where they apply. Yet, there are clear interactions between the two. The constitutional economics literature has begun to investigate some of those interactions, but it is still embryonic, narrowly focused on the

[23] It seems difficult to explain the dominant impact of recent economic performance without attributing at least part of the explanation for voters' election-year emphasis to cognitive biases (Healy & Lenz, 2012; Hill *et al*., 2012; Healy & Lenz, 2012).

[24] For example, drawing on US county level data between 1964 and 2000, Healy *et al*. (2010) found that a win by the local college football team in the week before election day increased the incumbent's vote share by about 1.6 percentage points in Senate, gubernatorial, and presidential elections.

[25] For example, Canes-Wrone & Park (2014) showed that pre-election periods were associated with falls in house sales across American states. The authors attribute this to the effects of political uncertainty typical of pre-election.

effects of different electoral rules and forms of government (e.g. presidentialism, parliamentarism) on fiscal variables such as government revenues, expenditures and budget deficits, and the interpretation of the empirical evidence is still highly contested. (For a brief review of this literature see Annex 2).

There is, however, a set of relevant studies in the political science literature that help build a more comprehensive picture of the connections between the particular features of a political system and the drivers of policy failure. These studies are spread across three bodies of scholarship which often talk past each other: political theory literature on the British constitution; empirical, comparative literature on the British macro polity; and empirical studies within constitutional economics. We now turn to this literature to examine the core features of the British system of government that have the potential to amplify some of the risks of policy failure discussed above.

The British system of government, the so-called UK Westminster model, is one of the ideal models of democracy described by Lijphart (1999, 2012) in a typology that remains very influential in academic thinking. (For more details see Annex 3.) According to that stylised description, the UK Westminster system is a majoritarian model of democracy, characterised by a unitary and centralised state, 'winner-takes-all' electoral rules, and a pluralist, competitive interest group system. The electoral system promotes concentration of power in single-party majority governments, dominant before Parliament (Rose, 1974). Proportional representation is sacrificed in the name of clearly-defined and easy-to-understand lines of accountability. This formal institutional set-up engenders an adversarial political culture, which prizes confrontation over compromise, contestation over accommodation. Compromise and accommodation are often seen as a sign of weaknesses (King, 2001). The essence of the system, as conventionally put it, is 'power-hoarding' (Lijphart, 1999; King 2001).

To be sure, this conventional characterisation of the British system has been contested. For one thing, it has been argued that the caricature of the Westminster model does not reflect the actual practices of British government. In particular, some scholars have contended that governance in Britain is more consultative, inclusive and moderate than often assumed (Jordan and Carney, 2013). For another, it has been highlighted that the country's constitutional arrangements have been changing in fundamental ways, and quite rapidly, most notably since 1997 (Bogdanor, 2009; King, 2010; Judge, 2014). Specifically, British constitutional experts have underlined that developments such as membership of the European Community (EC)/ European Union (EU), the endorsement of European Human Rights obligations, the enactment of Central Bank Independence, the creation of a Supreme Court, and the deepening of devolution within the UK have substantively altered the fundamental assumptions of the traditional British constitution, most notably by moderating the authority and power of the centre. Some authors see these changes as implying that British democracy has been drifting away from its traditional majoritarian roots (Flinders, 2010).

Furthermore, looking ahead, the trend towards electoral fragmentation is calling into question the conventional view of Westminster politics. The traditional view of the UK political system as a paradigm of strong and stable government, supported by the dominance of two large parties with mass electoral support alternating in power is no longer

accurate. England is moving quickly towards a five-party system (Conservatives, Labour, Liberal Democrats, the UK Independence party and the Greens, all of whom are currently scoring over 5% in the opinion polls), while Scotland, with the Scottish National party, has a six-party system. The development of multi-party politics and regional political divergences on the back of increasingly-fluid party allegiances represents a radical departure from the standard description of the Westminster model.

These are all important challenges to Lijphart's stylised, 'ideal-type' description of the UK Westminster system. They expose the limitations of that description, and especially the dangers of simplistic, sweeping generalisations. But the core institutional propositions of Lijphart's stylised description still prove valuable as an analytical starting point for making sense of some of the main features of British government (e.g. John *et al*. 2013;[26] King and Crewe, 2013; Fukuyama, 2014). They are also useful to frame the discussion that follows on the links between the British macro polity and the potential sources of policy failure discussed in the previous section.

Sensitivity to core and swing constituencies

Issues of functional and spatial representation, mediated by electoral rules and processes, are bound to affect and eventually bias the policy process in one way or another (Johnston, 1979). Any attempt to engage with the institutional foundations of policymaking in the UK should be sensitive to the set of incentives, including underlying distortions and biases, stemming from Britain's electoral geography and plurality voting system.

An accumulated body of empirical evidence suggests that the peculiarities of Britain's electoral geography do matter. We know, for example, that one of the hallmarks of British elections, the salience of constituency marginality, is associated with key political outcomes, including turnout (Johnston and Pattie, 2006); party campaign spending (Johnston and Pattie, 1995); the allocation of public funds (Ward and John, 1999; John and Ward, 2001; Bertelli et al., 2013); and local government fiscal policy (Besley and Preston, 2007). We also know that the way votes are translated into parliamentary seats has become increasingly disproportional (Johnston and Pattie, 2006), i.e. the gap between each party's share of the votes cast and its share of seats in the House of Commons has widened.

Ashcroft (2010) provides a vivid, insider account of the Conservative Party's strategy of targeting marginal seats and voters in the 2010 general election. The author was Deputy Chairman of the Conservative Party during the 2010 general election. According to his description, marginal seats (also known as 'battleground' seats), received the bulk of the party's attention in terms of campaign spending and resources. The party used data on the demographics, lifestyles and behaviour of individuals and households in the UK to identify (and target) people who were most likely to be undecided about their voting intentions and who could be persuaded to vote Conservative. Ashcroft estimated that the Conservatives won 32 seats from Labour and Liberal Democrats which they would not have if local vote shares had followed the overall national vote shift.

[26] According to Peter John and his collaborators, despite important constitutional changes, the fact is that policymaking in Britain is still concentrated in an executive led by the Prime Minister. In their words: 'A few key actors in government still determine the direction of policy.' (John *et al*., 2013, p.16).

The credibility conundrum of majoritarianism

The institutional architecture of strongly-majoritarian democracies involves a credibility conundrum (Majone, 1996a). The model assumes the burden of legitimacy and accountability lies in the possibility of alternation in power through regular elections. In a system with a relatively small number of veto players, future governments with different partisan agendas policies can easily reverse current policies. This can be advantageous in responding to shifting public preferences, and in supporting reform and innovation. It may also, however, undermine the consistency and effectiveness of policy, especially in areas where long-term commitment/credibility is important (e.g. investment in infrastructure).

Credibility dilemmas are also a potential source of policy failure in consensual democracies, but the problem is exacerbated in majoritarian systems. In countries like the Netherlands – the seminal example of relatively successful 'politics of accommodation' (Liphart 1968) – the bargaining of policy reforms tends to be slow and politically demanding, but the process often leads to more sticky, sustainable policy outcomes which are not constantly revisited or reversed (King, 2001). Furthermore, recent studies suggest that some non-majoritarian democracies may actually enjoy more flexibility and hold more policy capacity than often assumed (McGann and Latner's, 2013).

Studies comparing policy (in)stability between different political systems do not abound. There are, however, a few studies focusing on specific policy areas that help shed light on this question. One such example is Steinmo's (1989, 1993) classic studies of taxation, which indicate that British tax policy has tended to vary more than in a number of other advanced democracies. The author attributed this finding to the British electoral system, arguing that it presented successive British governments 'with strong incentives to act on their campaign promises even when these commitments were made with little analysis and though scarcely any attention was paid to their effects on the tax system as a whole' (Steinmo, 1989, p.529). Similarly, there is strong evidence of budget punctuations – i.e. abrupt changes in public expenditure preceded by periods of relative stability – in the UK (John and Margetts, 2003; John *et al*, 2013), which have been shown to be associated with a relatively-high degree of political polarisation (Breunig, 2006).

Another important piece of empirical evidence comes from a new wave of research on the British macro polity showing that public opinion and public policy seem to be related to each other in systematic ways. Shifts in public priorities, typically reflected in perceptions about the most important issues/problems currently facing the country, are important drivers of government policy agendas (Jennings and John, 2009; John *et al*., 2013). Moreover, there is evidence suggesting that public preferences often move 'thermostatically', in the opposite direction of the policies of parties in government (Soroka and Wlezien, 2005; Bartle et al. 2011).

Finally, government stability, one of the virtues of a majoritarian system in its own right, does not guarantee policy continuity (King, 2001). Stable governments are entirely consistent with unstable policies (and vice versa). High turnover of senior officials and cabinet reshuffles seem to be recurrent features of Westminster democracies (Kam and Indridason 2005; and Indridason and Kam 2006).

Perverse incentives regarding the use of information

An intensely-partisan and adversarial political landscape, characterised by reluctance to compromise, is not *a priori* well suited for effective use of information and constructive social learning. In theory, majoritarian systems are likely to foster non-inclusive patterns of policymaking where political actors, both inside and outside government, are incentivised to strategically misrepresent and manipulate information to score political points. In the event, 'evidence' becomes an instrument of party-political and interest-group competition, in ways that often harm the policymaking process.

The pattern of political and parliamentary debates in the UK, as well as the media representations of these debates, vividly shows that the winner-takes-all mind-set is deeply ingrained (Hood, 2013). The politics of blame avoidance and credit claiming, is also played along strong partisan lines. Simply put, the government party does not have incentives to compromise, and policy U-turns are typically seen as a source of opprobrium. On the other hand, the opposition is forced to invest a great deal of its political energy and resources in confronting the government's position and shadowing policy on a strong partisan basis. Comparatively few political resources, if any, are dedicated to the practice of consulting, reaching out, bargaining. In other words, there is a clear 'deficit of deliberation' (King and Crewe, 2013).

One recent example concerns the political dynamics that emerged in the aftermath of the 2008 financial crisis. The two main parties in the UK demarcated their differing positions on the best way to deal with the recession. While on the face of it, this was a 'battle of ideas', in truth it was inextricably linked to ideological predispositions and party strategy. This meant these party positions were not as flexible as they perhaps ought to have been in light of all available evidence (Dellepiane-Avellaneda, 2014).

In summary, there are aspects of the UK Westminster model that amplify some of the risks of policy failure discussed in the previous section. First, marginal constituencies/voters exert a disproportionate influence in policymaking. Second, the model is expected to deliver stable, decisive government, but in policy areas where commitment/credibility is important, the lack of consensus-building approaches can undermine policy effectiveness. Third, the interplay between an adversarial party-political culture and competitive interest group system creates incentives for political parties and legitimate interest groups to use information in ways that can damage the policymaking process.

Political economy of institutional reform

The proposition that institutions play a key role in shaping public policy is relatively uncontroversial. In the same vein, and as discussed in previous sections, there is a vast political economy literature showing that suboptimal economic outcomes and policy failures are rooted in institutional weaknesses. But what is the actual scope for institutional innovation? It is one thing to attribute a crucial role to institutions and eventually identify the institutional failings of a given political economy. It is rather another thing to engage in the highly-challenging business of reforming institutions. The literature reviewed in the previous sections helps to explain the institutional roots of poor policy outcomes. It also offers useful insights about the historical trends that underpinned the formation of current institutions and policies. Yet it struggles to shed light on the ultimate drivers of institutional change. (See

Annex 4 for an extended discussion of this point.)

The issue of institutional reform touches on two of the major problems in institutional analysis. The first one is that institutions which are meant to shape behaviour by structuring incentives are themselves the result of human choices. In academic jargon, institutions are *endogenous*, hence objects of investigation in their own right. The second problem is that while there is a solid body of scholarship accounting for the effects of institutions, the theory and empirics about their origins and evolution are still relatively underdeveloped. Despite numerous, laudable contributions to the literature,[27] institutional change remains 'intrinsically difficult' (Hall, 2010, p. 204) as a research topic.

A feature that stands out from the existing studies is their diversity of methodological approaches and interpretations. Different institutionalist strands[28] conceive of the nature and meaning of institutions, their functions and effects, their origins and evolution, in different ways (Hall and Taylor, 1996; Peters, 1999). This section draws insights from this vast literature, with an eye on identifying common ground among multiple traditions. The focus is on the limits and possibilities of institutional reform, and on how institutions evolve, including the conditions for and drivers of institutional change.

Before we move on to reviewing this literature, it is important to note that some institutional reforms involve changes in high-level/constitutional governance arrangements, whereas others operate within prevailing constitutional frameworks (e.g. Cox and McCubbins, 1997). Examples of the former include the use of independent bodies and governance mechanisms based on direct and deliberative democracy. (For a discussion of these mechanisms see Annex 5. For examples of recent, major institutional reform in the UK see Annex 6.) In the context of our project, they are both relevant insofar as they might help explain improvements in the policymaking process. Moreover, the drivers of institutional reform, which we are about to discuss, are likely to be the same.

Limits and possibilities of institutional reform

When the subject matter is institutional change, including the plausibility and degree of freedom in institutional reform, a word of caution is in order. To adapt a phrase coined by North (2005), we know a lot about institutions but little about how to fix them. Moreover, the process of change and improvement of imperfect institutions has not been a priority in political economy (Knack, 2003; Eggertsson, 2005).

There are several important warnings regarding the limits of 'institutional engineering'. First, the idea of a pristine design stage, i.e. that there is a 'constitutional moment' where distributional interests are put aside and electoral, partisan politics somewhat suspended on behalf of the common good, has little empirical traction. There are exceptions, such as certain events triggered by wars, security crises, and natural disasters, but they are uncommon. Even deep economic crises usually lead to periods of intense argument over ideas and institutions rather than more consensual forms of politics. Therefore, in practice, there is no sharp distinction between 'choices within rules' and 'choices about the rules' (Bardhan, 2005).

[27] See, for example, Alston *et al*. 1996, Knight & Sened, 1998; Thelen, 2004; Greif & Laitin, 2004; Grief, 2006; Mahoney & Thelen, 2010.
[28] For example, rational-choice, historical, sociological, and international.

Second, a major limitation in creating or reshaping institutions is related to short-term biases that affect not only policymaking but also institutional change (Pierson, 2000). Put crudely, institutional reforms may not make sense from a political perspective, because of a misalignment between institutional and electoral cycles. Today's institutions are, to an extent, a by-product of cumulative actions taken for short-term political reasons over the years. The other side of the coin is that today's reformers often face few incentives to care about the long-term benefits of institutional innovations, unless 'these become politically salient, or when they have little reason to fear short-term electoral retribution' (Pierson, 2000, p.479).

Third, transplanting institutions across societies, without serious consideration of local conditions and underlying political constraints, can be a recipe for disappointment, if not disaster (North, 2005, p. 161). The complex interplay between formal institutions, informal norms, and social learning is key to understanding institutional success and failure, and to explaining the inherent diversity of countries' institutional paths (Rodrik, 2009). A recurring problem is the tension between, newly-created formal rules on the one hand, and pervasive informal practices and traditions, evolving belief systems and cultural predispositions, on the other. The effects of institutional misfits range from weak enforcement of formal rules that undermine the effectiveness of reforms, to disruption of fundamental political equilibria and social order (North *et al*., 2009).

In a similar vein, any discussion about the limits and possibilities of institutional reform should be sensitive to underlying, institutional complementarities. Studies of advanced industrial democracies have identified powerful synergies among economic institutions (Hall and Soskice, 2001). Some famous examples include linkages between pension and wage-bargaining systems (Swenson, 2002), between corporate governance and industrial-relations models (Goyer, 2006), and between vocational education and training and labour market institutions (Thelen, 2003). It has also been shown that the conditions for economic development tend to be strongly and systematically 'clustered' (Besley and Persson, 2013).

The notion of institutional complementarities extends to the linkages between economic and political institutions (Hall and Soskice, 2001; Iversen, 2006). Specifically, majoritarian democracy tends to be grouped together with liberal-market capitalism, while consensual democracy is usually clustered with co-ordinated-market capitalism. Some have even argued that economic and political institutions are mutually self-reinforcing, making some political economy choices more or less likely than others. For example, there is some evidence to suggest that the creation of electoral support in favour of redistribution towards the poor is more difficult under majoritarian rule (Iversen and Soskice, 2006). Yet, it is clear that these constraints on choice are not set in stone. Take the case of independent central banking, which originally was a distinctive feature of federal countries, and currently is one of the anchors of economic governance in a large number of (non-federal) countries, including Britain.

None of this implies, however, that institutional frameworks – and by implication policy outcomes – cannot be improved. In fact, there is little else in the political toolkit than the chance to modify formal rules. It is much harder, if not impossible, to shape informal practices, attitudes, and mentalities (North, 1990). Moreover, the conscious adaptation of prevailing institutional structures may not be simply a matter of choice, but a necessity. It has

been argued, in particular, that the key to long-term prosperity is 'adaptive efficiency', namely a society's capacity and flexibility to modify or create institutions as problems evolve (North, 2005, p. 169). Some degree of institutional change may be required just to protect the *status quo*, i.e. 'institutional stability may involve a major dose of institutional adaptation' (Thelen, 2003, p.225).

Drivers of institutional change

The traditional narrative of institutional evolution is dominated by the idea of 'punctuated equilibrium' (Aoki, 2000). It posits that long periods of institutional stasis (equilibrium) are abruptly interrupted (punctuated) by sweeping changes in the face of exogenous shocks (typically profound economic and political crises). The emphasis is on continuity, persistence, stickiness, also known as path dependency, which is commonly used to account for the resilience of seemingly inefficient and dysfunctional institutions. Again, path dependency does not mean that institutions cannot change; it means simply that there are usually relatively high 'switching costs' (Levi, 1997).

The key sources of path dependency, in turn, are the self-reinforcing and positive feedback processes (so-called 'increasing returns') underpinning the evolution of existing institutions (Pierson, 2000, 2004). For example, institutions tend to generate outcomes which benefit vested interests with high stakes in the *status quo*; societies tend to develop ideas which normalise their performance and limit the range of feasible change (North, 1990, 2005).

On the subject of institutional change, the role of crises has received a great deal of attention. Classic works in political economy claimed that fiscal crises often structured conditions for major institutional transformations (North and Weingast, 1989; Root, 1989; Drazen and Easterly, 2001). There is an extensive literature looking at the renegotiation of rules and coalitions which takes place during critical junctures, quandaries, and dislocations (e.g. Collier and Collier 1991; Schofield, 2002; Acemoglu and Robinson, 2012). One of the key insights from this literature is that crises often shape the perception of the need for change. The deterioration of the status quo could make the need for change clearer, more salient (Akerlof, 1991), and alter the way individuals view the world, especially how they associate policy choices with outcomes (Harberger, 1993). Crises may also weaken the ability of interest groups to block socially-beneficial reform (Nelson, 1990, 1994), and lower the opportunity costs of change, turning previous adversaries into new supporters of reform.

Despite its merits, aspects of the punctuated-equilibrium model have been challenged over the years. It has been noted, for example, that the emphasis on continuity (equilibrium) masks the nuances of institutional dynamics that are not related to exogenous shocks or crises. Mahoney and Thelen (2010) argue that important patterns of 'gradual institutional change' are commonly observed in advanced industrial democracies. These subtle, incremental shifts, in turn, often add up to fundamental transformations, frequently in counterintuitive ways.

Several types of gradual institutional change have been identified, including 'layering', 'drift', and 'conversion' (Streeck and Thelen, 2005; Mahoney and Thelen, 2010). 'Institutional layering' involves the introduction of new rules on top of or alongside existing ones. 'Institutional drift' is associated with the changed impact of existing rules due to shifts in the wider economic and political environment in which institutional contracts are

embedded. 'Institutional conversion' is about the redirection of existing institutional resources to meet new ends and perform new functions.

The added value of these analytical metaphors lies in their capacity to offer a more nuanced understanding of real-world institution-making in advanced industrial democracies. For instance, the idea of layering has been convincingly applied to account for the evolution of various institutions, from the US Congress to the German vocational training system and the British House of Lords, as well as to the adaptation of the Economic and Monetary Union (EMU) governance structures over the Euro crisis. The core idea here is that old institutions, however dysfunctional in the present, are rarely totally dismantled. Too often, they are amended, revised and upgraded, often at the cost of institutional incoherence. On the other hand, though, layering may also increase the feasibility of institutional change.

The logic of drift also captures interesting real-world dynamics. The basic intuition is that a substantive renegotiation of existing institutions may be 'masked by stability on the surface' (Streeck and Thelen, 2005, p. 24). Change through drift may occur without explicit political manoeuvring, as individuals seek ways to accommodate changing economic and political conditions. Crucially, it may happen through the accumulated effect of 'non-decisions'. Classic examples are the evolution of health care and pension systems in various countries. But the contemporary evolution of the UK Westminster model also includes plenty of examples of institutional change that took place without an overarching political strategy, let alone new constitutional settlements (Flinders, 2010).

Alongside the role of crises and the notion of 'gradual institutional change', changes in ideas and beliefs are another major piece of the institutional reform puzzle. Ideas shape the way individuals define their interests and preferences, and mould their views about how the economy works, including how policies connect to outcomes.[29] Changing ideas can, therefore, become a driver of institutional reform. A 'belief cascade' can trigger paradigm shifts and rapid institutional transformations when society faces a severe quandary (Schofield, 2002). But incremental changes in beliefs, through policy and social learning, may also shape institutions on a more gradual basis and still lead to institutional innovation. North (2005, p. 3; emphasis added) once observed, 'The key to understanding the process of change is the intentionality of the players enacting institutional change and their comprehension of the issues.'

To be sure, ideas impose limits to institutional design, but they also open exciting possibilities. Dominant ideas about how the political economy works, and how it should work, constrain choice by delimiting the range of 'perceived legitimate change' (North, 2005). In this sense, ideas are a powerful source of path dependency, setting up the boundaries of institutional selection. But new ideas about innovative policies that enlarge the domain of policy initiatives deemed politically feasible, can also unlock change that is otherwise

[29] Rodrik (2014, p.194) suggests that the experience of the global economic and financial crisis in recent years and the extent to which it has altered beliefs is a compelling example. 'Many observers have argued that the policies that produced the crisis were the result of powerful banking and financial interests getting their way, which seems like a straightforward application of the theory of special interests. Still, without the wave of ideas "in the air" that favoured financial liberalization and self-regulation and emphasized the impossibility (or undesirability) of government regulation, these vested interests would not have gotten nearly as much traction as they did. After all, powerful interests rarely get their way in a democracy by nakedly arguing for their own self-interest. Instead, they seek legitimacy for their arguments by saying these policies are in the public interest. The argument in favour of financial deregulation was not that it was good for Wall Street, but that it was good for Main Street.'

trapped by an 'iron grip of vested interests' (Rodrik, 2014, p.194; Leighton and Lopez, 2013).

A related set of studies highlights that ubiquitous uncertainty about the political and economic effects of particular institutions may, on some occasions, create conditions for social learning and institutional innovation (Eggertsson, 2005; Mahoney and Thelen's, 2010).[30] For example, it has been noted that the opening up of gaps in the beliefs held by individuals in similar partisan and distributional camps may create unexpected entry points for institutional reform, unblocking complex negotiations over new institutions (Blyth, 2002).

The literature on monetary policy is full of examples of this mechanism at work. As a case in point, it has been argued that conflicting beliefs and constructive ambiguity underpinned the origins of the Euro, and that they are still clearly shaping its evolution (Dyson and Featherstone, 1999; Marsh 2009). Changes in ideas about the economic effects of different monetary institutions also appear to have contributed to the decision to move towards central bank independence in Britain in 1997 (Dellepiane-Avellaneda, 2013).

Conclusion

Defining and measuring quality of governance is a subject of dispute among economists and political scientists. The review of academic literature that we presented in this paper suggests that a useful way of thinking about quality of governance is to see it through the prisms of political representation and policy responsiveness. Biases in the domain of individual preferences and interests feeding into the political process (i.e. political representation), and/or in the alignment between individual preferences/interests and policy choices (i.e. policy responsiveness), are both likely to lead to suboptimal policy outcomes, i.e. of policy failure.

Problems of political representation have multiple potential sources, including cases where only some of those affected by policy decisions have a say in the outcome, and situations where political institutions aggregate conflicting individual preferences/interests into collective policy choices in ways that are open to distortions. Problems of policy responsiveness, in turn, reflect a variety of other possible imperfections in the link between voters' preferences/interests and policy decisions – the backbone of modern political economy studies. The most notable examples include distortions caused by core and swing voters and constituencies; rent-seeking activities; problems of policy credibility in areas where long-term commitment is crucial; and information imperfections.

Studies of the UK Westminster model reveal a number of features that amplify some of the risks of policy failure discussed in the political economy literature. Some of the most important examples include a disproportionate weight accorded to marginal constituencies and voters; lack of consensus building approaches in areas of policy where longer-term credibility and commitment is crucial; and incentives for political parties and legitimate interest groups to approach policy debates in ways that are damaging to the quality of the policymaking process.

The key to long-term prosperity is institutional innovation, namely a society's capacity and flexibility to modify or create institutions as problems evolve. The traditional account of

[30] Uncertainty regarding the ultimate consequences of institutions may also reinforce the bias towards the *status quo* (e.g. Shepsle, 1986).

institutional change paints a somewhat dispiriting picture, where evolution is characterised by long periods of institutional stability only interrupted by sweeping changes caused by exogenous shocks (typically profound economic and political crises). But other views that have been gaining traction reveal a more complex picture that features important patterns of subtle, incremental institutional change, often adding up to fundamental transformations. Furthermore, changes in ideas or beliefs (about individual interests and preferences, and how the economy works, including how policies connect to outcomes) are increasingly seen as another major piece of the institutional reform puzzle.

Annexes

Annex 1: The importance of institutions

Following Douglass North (1990, 1994), it is commonly accepted to conceptualise institutions as the humanly-devised constraints that shape human interaction. The basic idea is that institutions structure economic, political, and social behaviour by defining the 'rules of the game'. In other words, institutions establish the set of incentives – understood as systems of rewards and punishments – faced by economic and political actors. And, the arguments goes, different institutional frameworks imply different sets of incentives and hence induce different kinds of behaviour. In this sense, North's core argument is that both economic performance and political behaviour are shaped by the underlying incentive structure embedded in a country's institutional set up.

North makes two critical analytic claims regarding institutions. (For a detailed account of North's ideas, see Dellepiane-Avellaneda, 2012.) Firstly, he clearly distinguishes between institutions (the rules of the game) and organisations (the players of the game). Secondly, he strongly emphasises that the real incentive structure of a society is not only composed by 'formal' rules. Indeed, a country's institutional matrix consists of formal institutions, informal constraints, and their enforcement characteristics. These two distinctions are important for understanding institutional change and its effects.

In addition, the following three core ideas are worth emphasising: institutions are enduring features of economic and political systems; institutions are different from policies; and institutions are about both efficiency and redistribution.

An idea shared among institutionalist scholars is that institutions are relatively enduring features of economic, political, and social systems (Mahoney and Thelen, 2010, p. 4). Institutions do change, which is precisely the point of institutional reforms, but they cannot be easily or instantaneously modified at the will of political actors (Tsebelis, 1990).

This brings us to one of the central tenets of new institutionalism: the existence of a 'qualitative' distinction between policies and institutions. The claim is that the expected life of institutions (as constraints) is higher than the expected life of policies (Tsebelis 1990, p. 98). Moreover, the argument is that policies are actually made in the context of institutions. Of course, any patterned behaviour, including an enduring policy regularity, can become something akin to an institution in the long run, an expected feature of the system. Yet, in the short run, political and economic institutions shape policymaking by setting up incentives (Cox and McCubbins, 2000). The implication is that different institutional arrangements have differential and systematic effects on policy choices and outcomes. For example, the art of policymaking is substantively different under consensual or majoritarian democracies. Monetary institutions, including central bank independence, shape monetary policy; fiscal governance arrangements shape fiscal policy; and so on.

Finally, institutions are not only about Pareto efficiency; they are also about (re)distribution. While economists tend to focus on the efficiency gains associated with the emergence and evolution of institutions, political scientists tend to be concerned with their distributive nature. To an extent, institutions can be seen as negotiated solutions to problems of co-ordination and co-operation. But we should not neglect an important part of the story:

political institutions are also weapons of coercion and redistribution. They are the structural means by which political winners pursue their own interests, often at great expense to political losers (Moe, 1990, 2005; Knight 1992). They do not necessarily evolve to be socially efficient, but to satisfy the interests of those with the bargaining power to create new rules (North, 1994). This also means that many institutions do not emerge as 'equilibria among equal agents, but as equilibria in games among agents who control old institutions and agents who challenge such institutions with new demands' (Sened 1998, p. 162).

Annex 2: Constitutional economics

There is a long-standing debate about how different constitutional arrangements affect political and economic outcomes. Political scientists have long studied how electoral systems, in particular, differ in the way they allow citizens to influence policy through party-political representation and vote-based accountability. The typical comparison in the literature is between majoritarian electoral systems based on single-member plurality (SMP) districts and those that seek proportional representation (PR) through multi-member districts (MMD) (Farrell 2001, Przeworski *et al.* 1999, Powell 2004).[31] It is generally accepted that these alternative electoral rules involve a trade-off between representation/inclusion and vote-based accountability.[32]

PR has a greater propensity to generate broad and fractious coalitions compared to majoritarian systems, which usually yield single-party governments.[33] If coalition governments are formed through bargains between parties after elections, as it tends to be the case with PR, it becomes difficult for voters to anticipate how their votes will influence the parties that will make up government and the policies that will be adopted. This weakens vote-based accountability (Strom, 1990). It is also often argued that broad, fractious coalitions make it harder for voters to attribute responsibility for particular policy outcomes, compromising the effectiveness of retrospective voting (Powell 2000: 47-68, Hellwig and Samuels 2007).

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[31] A few points of conceptual clarification are in order. Electoral rules refer to the way votes translate into parliamentary seats. Under majority rule (also called plurality or first-past-the-post), only the candidate who secured the most votes in a district is elected; all other votes are 'lost' or 'wasted'. Under proportional representation, parties are allocated seats according to the proportion of votes they obtain.
Electoral systems include more dimensions than electoral rules, e.g., district size and ballot structure. District magnitude refers to the number of parliamentarians sent from one district. The ballot structure determines whether citizens can vote only for a party, only for an individual, or some combination thereof.
Although theoretically distinct, these dimensions are highly correlated empirically: countries using majority rule (MR) often have minimum district size (single-member districts) and allow voting for individual candidates. Countries relying on proportional representation (PR) often have large districts and restrict the possibility of deviating from party lists.
Dichotomy introduced by Lijphart (1999): 'Majoritarian' constitutions are characterised by plurality rule as well as a number of other characteristics, including governments dominated by the executive and usually one-party governments. 'Consensual' constitutions, on the other hand, are characterised by PR, greater balance of legislative and executive powers and tendency for the creation of coalition governments.

[32] For a discussion of the shape of this trade-off see Carey & Hix (2009). For a sceptical view about the existence of such a trade-off see Warren (2008).

[33] It has long been an established association between electoral rules and the number of parties (Duverger's, 1954; Lijphart, 1990). Plurality is associated with two-party systems; PR is linked to a more fractionalised party system. Recently, the implied direction of causality underpinning this association has been called into question – e.g. Colomer (2005) argued that it is the number of parties that determines the electoral system and not the other way around.

In recent years, economists have also shown increasing interest in investigating how different constitutional arrangements influence economic (mainly fiscal) outcomes.[34] Examples of the features of the macro polity that are usually considered include electoral rules, form of government (presidential vs. parliamentary), and whether a country has a federal structure or direct democratic institutions.

One influential theory suggests that it is easier for legislatures to collude with the executive in parliamentary systems, leading to higher tax rates and corruption than in presidential systems (Persson *et al.*, 1997, 2000). This is because, according to the same thesis, presidents do not depend on the continued support of the majority of parliament to remain in power, whereas the executive in parliamentary systems does. It is also commonly hypothesised that, in parliamentary systems, the majority (of voters and legislators) is likely to pass legislation (e.g. spending programmes) to make them better off to the detriment of the minority.

Other theories have focused instead on the tendency of PR to lead to a larger number of parties with parliamentary representation. They posit that this will increase the likelihood of legislative bargaining between parties with different constituents and, therefore, lead to higher tax rates (Austen-Smith, 2000). In majority rule systems, politicians face incentives to cater to the interests of those who can help them build a voting plurality, increasing the number of pork-barrel projects.[35] In PR systems, every vote counts so politicians would, instead, face incentives to provide more public goods (e.g. Lizzeri and Persico, 2001; Persson and Tabellini, 2000; Milesi-Ferretti et al., 2002).

A landmark empirical study in this area (Persson and Tabellini, 2003) reported surprisingly large economic effects of different constitutional rules.[36] To get sense of the magnitude of some of the results, it is worth noting they indicated, for example, that central government expenditure as a proportion of GDP was 10% higher in countries with parliamentary government and PR, than countries with presidential government and plurality rule. But subsequent studies have challenged some of the results,[37] by exposing their

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[34] Some of the key theoretical contributions include Myerson (1993), Persson *et al*. (1997, 2000), Persson & Tabellini (2000), Austen-Smith (2000), Lizzeri & Persico (2001) and Milesi-Ferretti *et al*. (2002). For a recent review of both theoretical and empirical literature see Voigt (2011).

[35] If candidates with the highest vote shares win every seat at stake in a district rather than seats in proportion to their vote shares, it becomes more attractive to target particular geographical groups, not the electorate at large.

[36] The authors drew on a sample of 85 countries over a period of almost four decades (1960 to 1998). With regards to the form of government, they found that: government spending is approximately 6% of GDP lower in presidential than in parliamentary systems; the size of the welfare state is some 2% to 3% lower in presidential systems; the effect of government form on the budget deficit is relatively small; presidential systems appear to be associated with lower levels of corruption; there are no significant differences in government efficiency between the two forms of government; presidential systems are associated with lower productivity growth (significant at the 10% level only).
With regard to electoral systems, they found that: in majoritarian systems, central government expenditures are approximately 3% of GDP lower than in proportional representation systems; expenditures for social services ('the welfare state') are 2% to 3% lower in majoritarian systems; the budget deficit in majoritarian systems is 1% to 2% below that of systems with proportional representation; a higher proportion of individually- elected candidates is linked to lower levels of corruption; countries with smaller electoral districts also tend to have less corruption; a higher proportion of individually-elected candidates is correlated with higher output per worker; countries with smaller electoral districts tend to have higher output per worker.

[37] E.g. Persson, Roland & Tabellini (2005) found that higher overall spending observed under PR appeared to be entirely explained by their a more fractionalised party system, and hence more frequent coalition governments than under plurality rule. More recently, Blume *et al.* (2009) found that Persson & Tabellini's (2003) results were not robust to minor methodological modifications. 'Increasing the number of observations from 80 to 92 makes the presidential dummy insignificant in explaining variation in central government expenditure. This is also the case as soon as a slightly different delineation of presidentialism is used. If the dependent variable is changed to

sensitivity to minor changes in methodology, including the regression specification used, the years covered by the dataset, and the control variables included in the model. The results associated with different forms of government (i.e. parliamentary *versus* presidential systems) proved especially sensitive to methodological changes, while the findings for electoral rules showed greater resilience[38] (Blume *et al.*, 2009). Furthermore, the research methods used do not exclude the possibility that it might not be constitutional rules that are driving the results, but rather third variables (e.g. informal institutions, ideologies, social capital) which might be influencing both the constitutional rules as well as economic variables. In other words, problems of endogeneity cast a shadow over the interpretation of these results.[39]

Recent developments in the literature go beyond the study of macro and high-level effects of constitutional rules on economic outcomes to include the detail of the institutions that intermediate the two (Spolaore, 2004). In the context of electoral rules for example, McGann and Latner (2012) argue that it is important to allow for two sets of institutions: the electoral system that translates votes into allocations of seats in the legislature (purely proportional at one pole, completely winner-takes-all at the other); and the decision making process whereby legislators (and other officials, elected or otherwise) arrive at government policy (simple majority rule or a certain degree of super-majoritarian rule).

Reflecting on the ability of different political systems to adapt to changing circumstances, e.g. changes in public opinion or exogenous shocks,[40] the authors' theoretical predictions suggest that PR-majority rule systems – what Lijphart (2012) calls 'consensus democracies' – should produce relatively-stable patterns of policy, while still being flexible and responsive to changes in public opinion. Super-majoritarian systems (e.g.

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total (instead of central) government expenditure, the dummy also becomes insignificant. PT's estimates of the effects of form of government on "graft" are based on data from 1997 to 1998. If data for the period 1996 to 2004 are used instead (or the number of observations is increased, or a slightly different definition of presidentialism used, or a combination thereof), the dummy becomes insignificant. For total factor productivity, PT did not find the presidentialism dummy significant. Interestingly, if a slightly different delineation of presidentialism or estimates of total factor productivity for 2000 (instead of 1988) are used, presidentialism becomes significantly (negatively) correlated with total factor productivity.' (Voigt, 2011, p. 224).

[38] Blume *et al.*, (2009) note that it appears to be the proportion of individually-elected candidates and the size of electoral districts that matter most, not the choice between first-past-the-post and proportional representation.

[39] For example, Bordignon and Monticini's (2012) recent study of electoral reform in Italy (from purely proportional to plurality rule), which avoids some of the methodological challenges of international comparisons, found no effects on either the number of parties or the stability of governments (the two main objectives of the reform). Voigt (2011) discusses at length these problems and possible ways of tackling them. There are very few empirical studies treating constitutions endogenously. Ticchi and Vindigni (2010) present evidence that lends some support to their hypothesis that consensual systems are likely to be preferred by societies where *ex ante* income inequality is relatively low, while a majoritarian system is likely to be preferred when income inequality is relatively high. Hayo & Voight (2013) study changes in the form of government based on a sample of 202 countries over the period 1950 to 2006. They find that most changes are relatively small and roughly equally likely to be in the direction of more parliamentarian or more presidential systems. Empirical results for a 146 countries over the period 1951 to 2000 suggest that such changes in the constitution can be explained by characteristics of the political system, internal and external political conflicts, and political leaders, whereas economic and socio-demographic variables do not matter.

[40] A related literature has looked at the ability of different governments to adopt policies to undertake major fiscal adjustment, reducing significantly a large budget deficit and/or stopping large inflation. Hamman and Prati (2002) found that the larger the number of institutional constraints on the executive the more delayed and less successful are inflation stabilisations. Veiga (2000) reports that an index of government fragmentation is a good predictor of the delay of inflation stabilisations. Alesina, Perotti & Tavares (1998) show that coalition governments in OECD countries are less likely to implement successful fiscal stabilisations. Alesina, Ardagna & Trebi (2006) found that stabilisations are more likely to happen when a crisis occurs with a 'strong' government (e.g. presidential systems; executives facing fewer institutional veto points; in periods of unified government in which the same party holds the executive and the legislature; and when the majority of the ruling party, or parties, is large).

as in Germany and Switzerland) are expected to be more stable and less responsive to shifts in public opinion.[41] Systems with winner-takes-all elections and no super-majoritarian checks (e.g. the Westminster system) should display a great deal of policy change as governments alternate, with unclear implications for long-run patterns;[42] winner-takes-all super-majoritarian systems (e.g. as in US) are predicted to be extremely immobile. The study uses an international comparison of changes in government expenditure to adduce empirical support to these predictions.[43]

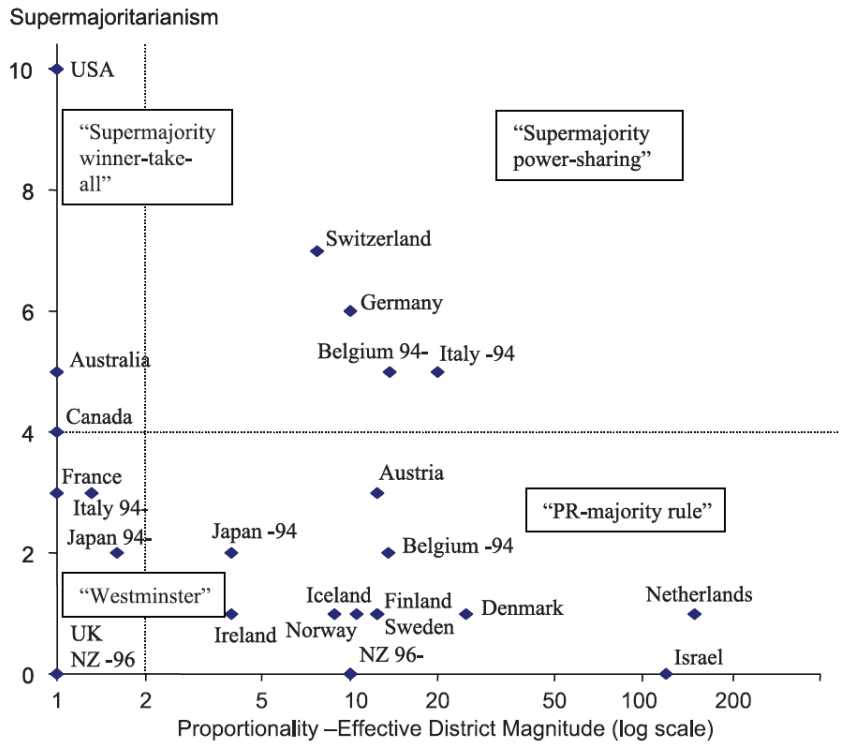
Figure 1: Constitutional types in the OECDfrom McGann and Latner (2013, p.828) plots Organisation for Economic Co-operation and Development (OECD) countries along two dimensions: scores on electoral system proportionality and super-majoritarianism. Countries with winner-take-all electoral systems have effective district magnitude less than two, whereas systems that are broadly proportional have effective district magnitude greater than two. The distinction between countries with simple majority rule and those with super-majoritarian features is made through a dividing line which is set somewhat arbitrarily at a score of 4. The results are, therefore, expressed in four categories: 'PR-majority rule'; 'super-majority power-sharing' (PR with super-majoritarian checks and balances); 'super-majority winner-takes-all'; and 'Westminster' (simple majority rule legislature with winner-takes-all elections).

[41] Stability should not be confused with predictability or lack of uncertainty. The struggles that the US found in 2013 to deal with the debt ceiling offer a stark example. 'Investors in the US economy traditionally take solace in the extensive checks and balances embedded in the American constitution. Presidents are often derailed by divided government, Senate obstructionism, and opposition from co-partisan legislators. In recent years, however, these sources of status quo bias have often reinforced rather than reduced policy uncertainty. The status quo is unattractive when the debt ceiling must be raised to avoid default or fiscal adjustment is required for a sustainable debt path. Yet change from the status quo under American-style separation of powers typically requires the agreement of both parties, creating tension that leads to high-stakes bargaining scenarios in which players face political incentives for brinkmanship that in turn generate high levels of uncertainty.' (Baker *et al.* 2014, p.3)

[42] According to the authors, the uncertainty about the long-run patterns of Westminster-type systems is due to the fact new pluralities of the popular vote at subsequent elections could easily lead to new governments that reverse policy changes. It is possible that these alternating pluralities could offset each other, producing a series of oscillations that leave us essentially where we started – a kind of 'stochastic veto' effect.

[43] The authors use OECD data on aggregate government spending (1968 to 2000) and disaggregated government spending data from the IMF (1972 to 2000) to test these claims. They report that PR-majority rule countries increased the size of government expenditure more than the other forms of democracy, but they have also reduced spending from the peak more than other systems. The super-majoritarian systems (whether proportional or winner-takes-all) did not reduce spending much (although in the case of super-majoritarian winner-takes-all systems the peak level of spending was comparatively low). In the Westminster systems there was also considerable growth and retrenchment. The average retrenchment of Westminster systems was lower than that of PR-majority rule systems, but the number of cases was small and influenced by outliers. The empirical analysis does not prove causality between constitutional setup and policy outcomes. But it suggests the argument that PR and multi-party government are incompatible with rapid policy change should be rejected. PR-majority rule democracies appear at least as flexible as the Westminster democracies.

Figure 1: Constitutional types in the OECD



Source**:** Figure 1 in McGann and Latner, 2013, p.828.

Annex 3: Lijphart's patterns of democracy

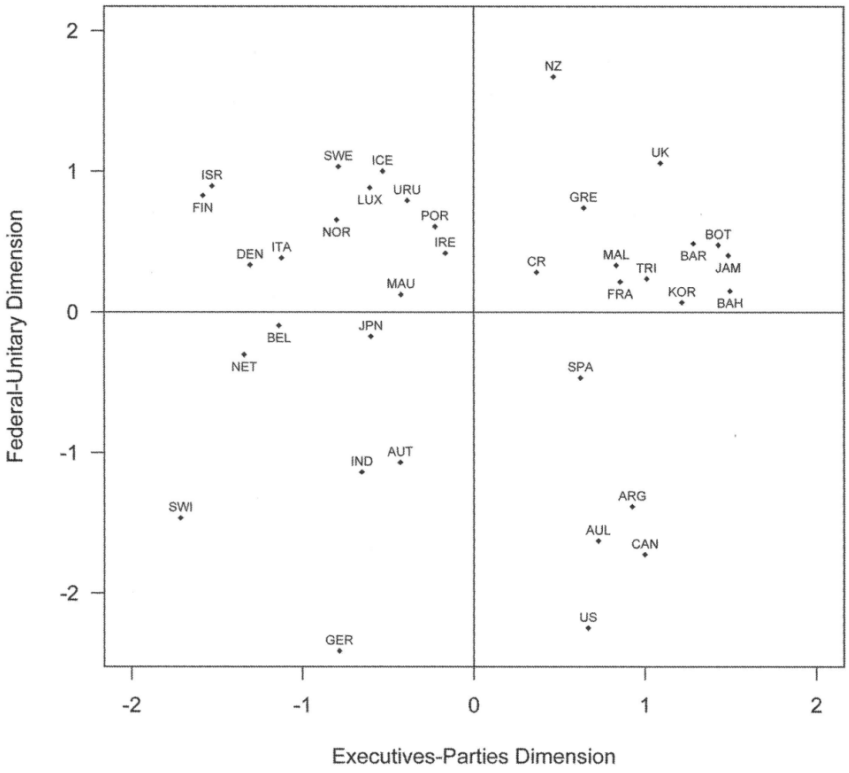
Lijphart (1999, 2012) posits that democratic systems can be classified in a continuum between majoritarian and consensualist poles. The majoritarian model is a power-hoarding constitution. It is generally nurtured by a winner-takes-all electoral system, an adversarial political culture and a competitive party system based largely around two dominant parties. In the consensus model, power is shared and this is commonly achieved through a proportional electoral system, a consensual political culture and a party system involving a number of parties. Lijphart places political systems in a two dimensional 'conceptual map'. The two dimensions 'executive-parties' and 'federal-unitary' represent clusters of five characteristics each.

There are five differences on the executives-parties dimension: concentration of executive power in single-party majority cabinets versus executive power-sharing in broad multi-party coalitions; executive-legislative relationships in which the executive is dominant versus executive-legislative balance of power; two-party versus multi-party systems; majoritarian and disproportional electoral systems versus proportional representation; pluralist interest group systems with free-for-all competition among groups versus co-ordinated and 'corporatist' interest group systems aimed at compromise and concertation.

There are five differences on the federal-unitary dimension: unitary and centralised government versus federal and decentralised government; concentration of legislative power in a unicameral legislature versus division of legislative power between two equally-strong but differently-constituted houses; flexible constitutions that can be amended by simple majorities versus rigid constitutions that can be changed only by extraordinary majorities;

systems in which legislatures have the final word on the constitutionality of their own legislation versus systems in which laws are subject to a judicial review of their constitutionality by supreme or constitutional courts; central banks that depend the executive versus independent central banks.

Figure 2: two dimensional conceptual map of democracy – based on average for 1945-2010[44]

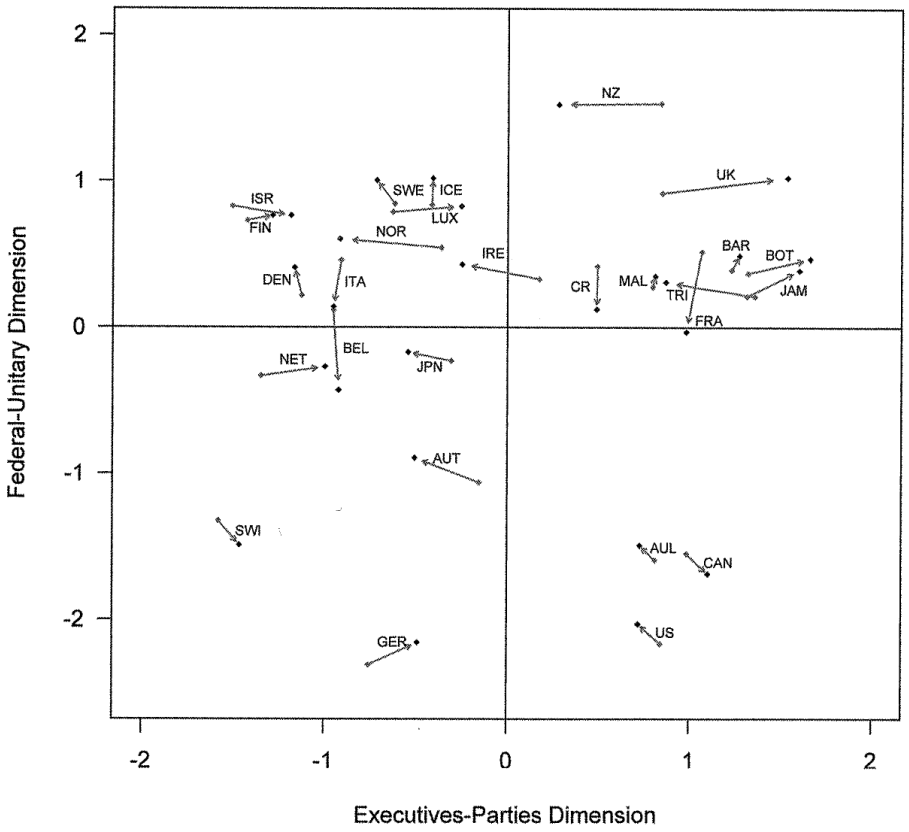


Source: figure 14.1 'The two-dimensional conceptual map of democracy' in Lijphart 2012, p.244.

Figure 2: two dimensional conceptual map of democracy – based on average for 1945-2010 is based on an average for 1945-2010. Lijphart (2012) divided the period 1945-2010 in two roughly equal parts: the period until the end of 1980 and the period from 1981 to the middle of 2010 (Figure 3: Shifts from the period before 1981 to the period 1981-2010). The results for the UK show a large shift to the right. This occurred 'in spite of slight increase in the effective number of parties (from 2.1 to 2.27 parties), which was more than counter-balanced, however, by a big increase in disproportionality (from 8.97 to 16%) and a higher degree of executive dominance. These changes demonstrate that by 2010 the UK had definitely replaced New Zealand as the closest approximation of the Westminster model' (Lijphart, 2012, p.252).

[44] A minimum period of 22 years was used for the three newest democracies.

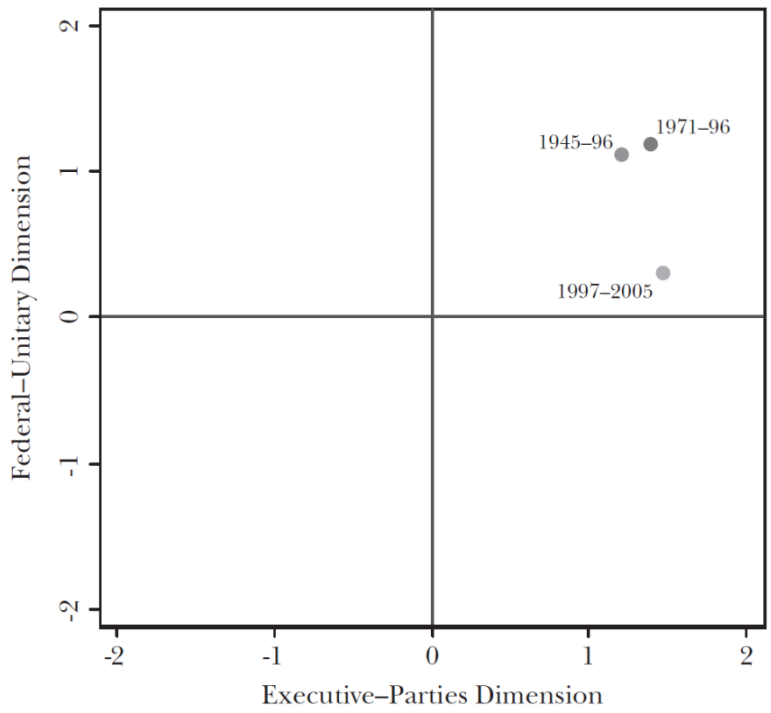
Figure 3: Shifts from the period before 1981 to the period 1981-2010



Source: Figure 14.2 'Shifts on the two-dimensional map by 27 democracies from the period before 1981 to the period 1981-2010' in Lijphart (2012), p.251

Analysing different time periods, Flinders (2009) suggests that the British democracy changed under New Labour, but that this change was one sided (Figure 4: Two-Dimensional Conceptual Map of Democracy in Britain 1945–96, 1971–96, 1997–2005). He argues there was a shift along the federal-unity dimension, reflecting devolution, the creation of a Supreme Court and an increase in central bank independence. However, there has not been an equivalent shift on the executive-parties dimension. On the contrary, the change on this dimension suggests a slight increase or greater concentration in executive power since 1997.

Figure 4: Two-Dimensional Conceptual Map of Democracy in Britain 1945–96, 1971–96, 1997–2005



Source: Figure 1 'Two-Dimensional Conceptual Map of Democracy in Britain 1945–96, 1971–96, 1997–2005' in Flinders (2009), p.395.

Annex 4: Political economy of reform

The development of studies in political economy that have focused specifically on institutional reform are closely associated with recurring crisis in a number of Latin American countries in the 1970s and 1980s, and with the transition of the former Eastern Bloc from central planning to market economies in the 1990s (Olofsgård, 2003).

The Latin American experience prompted the question of why reforms that, at the time, gathered wide support amongs most mainstream economists, international financial institutions and some western governments, were not being implemented?[45] (Williamson and Haggard, 1994). Efforts to address this question highlighted the potential for conflicting preferences and interests among different groups in society to block or delay socially-beneficial reforms.[46] The models used were essentially the same that the wider body of political economy literature had developed: e.g. models capturing the role of powerful vested interest groups in blocking reform; situations where individuals view policy change as desirable, but everyone who benefits wants someone else to bear the cost, causing inaction or delays; ex-ante uncertainty about the benefits of reform, undermining its electoral support; and asymmetric information between policymakers and the electorate about the effects of policy change, making the electorate suspicious of the motivations underpinning policy change and thus rejecting it.

[45] In the main, reforms that captured by the so-called 'Washington consensus', focusing on trade, tax, deregulation, and macroeconomic and legal reforms.
[46] The empirical focus was mainly on macroeconomic stabilisation and trade reforms.

The experience of the Eastern Bloc's transition to a market economy model raised a different set of questions. The main focus was normative: how can reform processes be designed to overcome political resistance? The relevant academic literature was thin. The models that were subsequently developed relied on the assumption that there was a reform-minded government in power whose plans faced political resistance. The key decision making variables in those models are related to the design of the reform package, and the political support that it attracts. For example, some of the alternatives considered included whether to bundle reforms or to opt for a more incrementalist approach (gradualism); whether or not to offer compensation to losers from reform; and how to allocate their benefits.

One recent study that follows a similar line of thinking is Boeri *et al.* (2006). It draws on a series of case studies across a range of topics (e.g. labour and product markets, the welfare state, and privatisations) and political systems (e.g. UK, Denmark, Italy, Russia and the Czech Republic) to devise four 'recipes' for reform: exploiting political power or parliamentary majority; building consensus for reform by tailoring the reform package to widen the political base of support, i.e. by spreading more widely the benefits of reform; using 'divide and conquer' strategies, i.e. targeting the benefits of reforms at specific subgroups, so as to undermine intra-group cohesion;[47] and exploring external constraints, e.g. international laws or regulations that make reforms inescapable, to push through reform.

In summary, the literature inspired by the Latin American experience simply re-rehearses the hypotheses of mainstream theories of political economy of government failure. It is not, therefore, very informative about the roots of institutional change. The studies that came in the aftermath of the transition of the Eastern bloc, on the other hand, take as a given that power lies in the hands of a reform-driven government. The trouble is that making such an assumption simply eschews the fundamental question about the determinants of institutional change.

Annex 5: Beyond the ballot box

In modern democracies, political representation and accountability are not confined to legislative elections. Societies have been experimenting with a range of institutional arrangements in an attempt to address some of the shortcomings of standard political processes.

Some of these experiments have involved deliberately weakening electoral accountability, either through the introduction of policy rules[48] or by insulating decision makers from direct electoral pressures. One important example is the delegation of policy instruments to independent agencies. From a normative perspective, it has been argued that delegation is likely to be advantageous where social preferences are stable; precise policy goals can be specified; it helps to overcome problems of credible commitment; and first-order distributional impacts are not relevant (Alesina and Tabellini 2007, 2008). Central bank independence is, of course, the most widely-cited and scrutinised case. It has been claimed that monetary policy is somewhat peculiar, in that it combines short-term biases (related to

[47] The classic example in electoral politics describes the strategy of bringing about a new alternative to divide an existing majority, upsetting the prevailing equilibrium.
[48] For example, rules designed to constrain the ability of government to run deficits or issue debt (e.g. balanced budget laws, expenditure ceilings, and restrictions on the issuance of debt).

time inconsistencies) with an ability of society to agree on policy goals (Drazen, 2002). That ability to agree is helped by the fact that the distributional implications of monetary policy are mainly across time and relatively opaque between groups. In contrast, fiscal policy tends to have very clear distributional implications,[49] and keeping it under direct political control is often critical to building minimum winning coalitions among voters.[50]

One aspect of delegation that has not received much attention in the literature is the set of incentives and motivations that shape the behaviour of those who run independent agencies. A recent study indicates that central bankers are moulded by their professional backgrounds, and driven by career concerns, which have an impact on the way they manage monetary policy (Adolph, 2013).[51] The same study suggests that through careful appointment and retention of central bankers, partisan governments can and do influence monetary policy. Hix *et al.* (2010) reach similar conclusions in their analysis of the voting records of members of the Bank of England's Monetary Policy Committee (MPC) and of the pattern their reappointments.

Tucker (2014) contends that central banks should operate in a way that makes transparency a basis for public debate and scrutiny 'rather than the means to a technically elaborate deception' (p. 51). He sees central banks as social institutions shaped by the circumstances of their creation, the way their mandates are framed and reactions to their performance. The result, he claims, is a reputation (for competence, reliability, trustworthiness) that depends on the transparency and understanding of the outputs of central banks, on the extent to which their mandate catered for exceptional circumstances, and on the channels for scrutinising them and for publicly debating their conduct and performance. He admonishes, 'Don't think of the "conservative central banker" but of the "scrutinised" central banker and, if those forces are strong enough, perhaps of the "dutiful central banker"' (p.50).

There is a parallel here with the role of independent agencies that concentrate on fiscal policy.[52] The most common ones lack decision making power, but provide independent projections of budgetary variables and evaluate the alignment of budgetary policies with governments' long-term objectives.[53] In a small number of cases, their remit extends beyond budget outcomes and fiscal policy narrowly defined, helping to raise the quality of the political debate. The most cited example is the Netherland's Bureau for Economic Policy Analysis, which undertakes research on a broad range of policy issues (e.g. employment, regulation, resource depletion and financial crises) and assesses policy options put forward by government and opposition parties.[54]

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[49] More or less inflation, a more or less active anti-cyclical policy has redistributive implications. But they are less clear and direct than those caused by an increase in the progressivity of the income tax, or a tax or subsidy for this or that sector/income group.

[50] In this respect, Alesina & Stella (2010, p. 21) claim that 'packaging redistributive flows from income groups to income groups, regions to regions, lobbies to lobbies is what politics is mostly about. This is a reason while fiscal policy is virtually never delegated to independent agencies even though it is plagued by time inconsistency problems just as much, if not more than monetary policy'.

[51] For example, central bankers with financial sector backgrounds were found to preside over lower inflation, while central bankers with bureaucratic backgrounds were associated with periods of higher inflation.

[52] See Debrun *et al.* (2009) and Calmfors (2011) for a survey of this literature.

[53] In the UK, this is the remit of the Office of Budget Responsibility.

[54] Other examples include the Economic Council in Denmark and the Fiscal Policy Council in Sweden.

Direct democracy is another approach that some countries have adopted to tackle the limitations of the standard political process, and that has been extensively studied in political economy literature, with a particular emphasis on referendums and initiatives.[55] Proponents of direct democracy argue that it could make politicians more accountable and lead to policy choices that more closely match those of the median voter. Two particular mechanisms could be at play: helping voters to address principal-agent problems, and avoiding/mitigating biases caused by the bundling of policy issues (log-rolling) under representative democracy. In the first case, direct democracy could allow voters (principals) to 'override' inadequate decisions of agents; or the threat of override could itself be sufficient to prompt agents to act in ways that are more aligned with voters' preferences. In the second case, direct democracy could help capture the full gamut of voters' preferences by unbundling policy issues. It could also lead to higher interest in politics, higher voter turnout and increased political legitimacy (e.g., Smith and Tolbert, 2004).

Critics of direct democracy have noted that it is open to abuse by well-organised special-interest groups to push their own agendas (Matsusaka and McCarty, 2001)); that elected representatives are likely to have more or better information at their disposal than citizens at large; and that a greater alignment with the preferences of the median voter is not necessarily a socially-desirable outcome.

Differences between governments with and without direct democracy institutions are well documented (e.g. Matsusaka, 2005, 2013). For example in the US, states that use initiatives have been shown to choose different policies across a variety of issues, including taxes, spending, abortion, death penalty, and term limits. These policy options appear to be more congruent with public opinion. It remains, however, unclear how exactly these differences come about, since many of them cannot be traced to choices made through the ballot. There is some anecdotal evidence that legislatures respond to initiative threats (Crouch and Key 1938; Gerber 1998) and that legislatures care about even unsuccessful measures (Gerber 1999), but for the most part, our understanding of the relative importance of these different channels is still incipient.

Deliberative democracy is another alternative to the standard political process. This broadly includes political processes designed to support analysis and evaluation based on an understanding of the 'needs and principles of everyone affected by the matter at hand' (Mendelberg, 2002, p.153). Like direct democracy, these processes aim to enhance accountability and political legitimacy, but they operate in distinct ways. It is not just an attempt to make policy more responsive to public preferences due to the strengthened voting channel (as in direct democracy), but also a way of strengthening accountability through the need to justify policy decisions in an open forum where adequate information is available to all participants (Chambers, 2003). The theory posits that political legitimacy increases because citizens become more engaged, their tolerance for opposing points of views increases, and they feel empowered by participating in the policymaking process (e.g. Carpini et al., 2004).

The empirical evidence is still mixed. The success of deliberation is very much context-dependent, depending critically on the way deliberative processes are designed

[55] Referendums are normally used to pass certain types of legislation, in which case the agenda-setting power remains with Parliament, although citizen consent is required. Initiatives allow citizens to set the agenda by proposing pieces of legislation to then be decided.

(Mansbridge, 1983; Walsh, 2003a). At a micro level, research from experimental set ups and from the field of social psychology indicates that face-to-face communication increases the likelihood of co-operation (Ostrom 1998; Sally 1995). Deliberative forums organised by governments and non-profit organisations have also been shown to develop coherent interests, widen political communication networks and change political opinions (Gastil 2000; Briand 1999, Sirianni & Friedland 2001). Other studies in the same tradition, however, have come to more negative conclusions, with no measurable changes in political engagement or attitudes in some cases (Berry et al, 1993; Tyler, 1994; Tyler and Mitchell, 1994), and failure to impact on policy in other cases (Lindeman, 2002).

Annex 6: Examples of major institutional reform in the UK

Independence of the Bank of England

The economic merits of central bank independence are well rehearsed. (See discussion in Annex 5). Yet, it is still widely debated why governments would give power away, of their own accord, when it is generally accepted that politicians are in the business of accumulating power rather than giving it away. There is no shortage of hypotheses that propose to resolve this puzzle (e.g. Tager, 2007, for a review): it has been argued that federal states have higher levels of central bank independence because of their constitutional structure of dispersed power, whereas unitary states like Britain that concentrate power tend to have less independent central banks (Banaian, Laney, & Willett, 1986; Lijphart, 1999); that central bank independence can address political problems related to pressures from financial interests (Goodman, 1991); conservative governments expecting to lose power may want to limit the discretion of its probable leftist successor (Boylan, 1998); a divided government seeking to resolve disputes about economic policy may opt for shifting decisions to a third party (Bernhard, 2002, 1998); delegation may provide a vehicle for ‘strategic shirking’ by politicians seeking to avoid blame for economic downturns (Semler, 1994), and handle contradictory demands from the public for expansionary economic policy and from global financial markets for restraint (Bowles & White, 1994); and, finally, that certain ‘epistemic communities’ diffuse ideas (like central bank independence) that eventually win consensus and assume a ‘taken-for-granted quality’ (King, 2005; Marcussen, 2000).

Yet, despite this wealth of hypotheses, the context in which the shift to central bank independence took place in the UK seems to escape the scope of these relatively conventional accounts. Instead, it seems that the notion of self-interested political manipulation of constitutional design offers a more suitable explanation (Dellepiene, 2013). More precisely, it appears that by strategically delegating power in 1997, the Labour government made an institutional choice that constrained potential challengers while simultaneously increasing the capacity of the Treasury to control other departments’ plans. It allowed a left-wing party lacking anti-inflation credibility to signal commitment to responsible monetary policies; gave the Chancellor of the Exchequer (Gordon Brown) and the Treasury greater independence from Downing Street and far greater authority over other departments; and formulated a pre-commitment strategy that bound others, including members of

government[56] and powerful interest groups. It was not so much about the merits of self-binding reflected in the credibility gains from 'depoliticising monetary policy', as about the politics of institutional change that led to binding others.[57]

Of course, other factors were at play. For example, over time, there was a change in the underlying beliefs about how the economy was best managed which made the idea of independent monetary policy more palatable. Also, the entry to and exit of sterling from the European Exchange Rate Mechanism shaped the nature of the Bank of England's relationship with the Treasury and stimulated further exploratory work around the (dis)advantages and the practicalities of an independent Central Bank (Patel, 2008).

These factors were important but insufficient on their own to prompt change. Political strategy considerations proved to be crucial in influencing the results. Under the Thatcher and Major eras, failure to shift to Central Bank Independence owed primarily to party politics. Thatcher 'could not accept the idea of handing control to the Bank at the moment inflation was accelerating… Major had beaten inflation; he did not want to hand the credit to the Bank' (Stephens, 1996, p. 279); on top of that, 'people were frightened how Labour would handle monetary policy and he didn't want to remove that fear' (For Lamont, 1999, p. 325).

Competition law and policy

A modern, statutory competition regime emerged in Britain only after the Second World War. In the next 50 decades after the war, the development of competition law and policy was tentative, partial, and under-enforced. The country would have to wait for the passing of the Competition Act 1998 and the Enterprise Act 2002 to benefit from a coherent regulatory scheme, underpinned by an orthodox rationale. Scott (2009) offers a good historical account of these developments and this sub-section draws heavily on his work.

That the UK has only relatively recently adopted a serious competition regime is a perplexing fact. The country has for many years (especially from the 80s onwards) been a paragon of the neoliberal philosophy, placing great faith in markets and market-inspired solutions for allocating resources. Privatisation, liberalisation, deregulation, and the 'contracting out' of public services are testimonies of this trend. And yet, somewhat paradoxically, some of the institutional cornerstones for efficient, competitive markets only emerged in the last 15 years.

Among the factors that may help explain this relative tardiness in embracing an effective competition regime are a persistent Victorian commitment to a *laissez-faire* approach; a perception of the (apparent) value of unrestrained monopoly, conglomeration and cartelisation in the face of changed conditions of international trade; a strongly-corporatist approach to government-industry relations; and, much later, the influence of European Community Competition Law which ensured a degree of supervision of anti-competitive agreements and practices of the very largest corporate entities.[58] The upshot

[56] That is, parts of the Labour party with more activist monetary policy preferences.
[57] This work also suggests that, as far as politicians' motivations are concerned, a stark distinction between in-period choices (choices given rules) and constitutional choices (choices about the rules in a 'pristine design stage') is not warranted.

[58] That is those whose behaviour might impinge upon trade between member states of the European Community.

was that, before World War II, there was a lack of antitrust law which contrasted with other major jurisdictions. And after the War, the emergence of such a system was protracted, unsystematic, each reform introduced spasmodically on a four- or five-year cycle, in response to short-term pressures and focusing on divergent aspects of competition policy.

On the whole:

> The complexity and ambiguity of British competition agencies and law, as they stood in 1997 ahead of the Labour reforms... reflected peculiar policy dynamics. The policy did not grow from a clear design or a policy vision. They were not forged in a furnace of public outrage (as in the US); they were not imposed as part of the fruits of victory (as in Japan); neither were they conceived as part of a vision of political and economic integration (as with the EEC [European Economic Community]). Instead British policy emerged piecemeal and incrementally (Wilks, 1999, p. 173).

The first statutory intervention in 1948, with the passing of the Monopolies and Restrictive Practices (Inquiry and Control) Act, was a turning point. It emerged out of the reconstruction and social justice agenda of the period; the desire to orient corporate power towards serving general social interests; and the aspiration of full employment combined with the presumption that it would most likely be achieved if anti-competitive behaviour was discouraged. The enthusiasm for the new law was politically bipartisan.

The legislative scheme was ‘timid’ and largely educative only, but it helped change attitudes to competition. For some, it triggered a ‘psychological convulsion’ (Allen, 1966). The act drew the attention of business, policymakers, and the wider public to the advantages of competition and the costs of monopolistic behaviour, which promoted calls for further intervention. These calls were strengthened by subsequent reports (e.g. 1955) that exposed the prevalence of collective discrimination in the form of agreements on exclusive dealing, collective boycotts, aggregated rebates and other discriminatory practices.

Another driver of change was the attitude of many business leaders towards the discretionary system introduced by the 1948 Act. There was widespread discontentment among this group regarding the perceived room for arbitrariness and political manipulation in the prevailing regulatory framework. This triggered calls for a more juridical regime, that offered a greater degree of legal certainty, and that – so it was hoped – would not constrain business freedom too much.

The culmination of 30 years of post-war sporadic new thinking and incremental reform was a system that had few supporters. There was sharp criticism that the system was extremely complicated; that it failed to provide competition agencies with effective investigative powers and sanctions; that it placed unnecessary burdens on business and regulators while at the same time diverting attention away from illicit, hard-core cartels; and that there was an unhelpful discrepancy with competition law developed by the European Community.

The reasons for the prolonged inaction on the part of successive governments until 1997 are still debated. It has been suggested that Conservative governments from 1979 might have been simply too busy with other policy priorities. There is also the suspicion that earlier governments may have become too beholden to business interests, failing to recognise that where this verged towards protection from competitive forces and undermining the interests of the country at large. It has been noted, for example, that a

number of proposals for reform that were expected to be implemented by 1991, were later shelved following self-serving complaints from industry that well-understood principles would be replaced by a regime based on uncertainty.

Within weeks of the Labour party coming into office in 1997, a new Competition Bill was published. It provided for the transposition of something very much like European Community competition law into United Kingdom law, introducing general prohibitions of anti-competitive agreements and abuse of a dominant position. The Competition Act 1998 was brought into full force in March 2000 and marked the beginning of a new era of competition law and policy in the UK.

Structural changes in infrastructure policy

Britain's infrastructure policy has suffered large swings over the twentieth century, with a shift towards the public sector in middle of the last century, privatisation in the 1980s, and a 'return of the state' over the last decade and a half. Helm (2009, 2013) offers a good overview of the context in which these reforms occurred and the following remarks draw heavily on his work.

For most of the 19th century, Britain's infrastructure was heavily dependent on private sector initiative. In some areas – e.g. transport – it seemed to work relatively well (Boggart, 2014). Yet, rapid urbanisation created pressures on public health infrastructure that demanded local government intervention. In the 1930s and 40s, the investment record of the private sector was perceived to be relatively poor, short-termist, and too fragmented to provide effective support to the development of the electricity grid and transport networks required. The great depression of the early 1930s helped to shift mainstream economic and political thought, suggesting that public enterprise could be more efficient than private. The mobilisation imposed by World War II completed the shift towards greater reliance on state intervention. When the UK re-emerged from the War, the most significant parts of its infrastructure (energy, post, telecommunications, roads, rail and housing development) were under public sector control and would remain so for at least the next 40 years.

The new approach was fairly successful in meeting infrastructure needs derived from the economic boom that followed the War that lasted until the 1970s. But with time, a number of important faults became exposed. These were especially salient in energy: the creation of labour monopolies and increasingly-disruptive forms of 'industrial action'; deterioration of investment and operating-cost performance;[59] and public spending controls, introduced after a prolonged increase in the size of the state and at a time when further increases in taxation were not politically feasible. Capital expenditure bore the brunt of budgetary pressures, rendering further public investment unworkable.

[59] The State monopolies became increasingly producer-driven, captured by the interests of non-executive political appointees and of their own work-force. This translated into excessive levels of investment and wages as well as services and prices designed for political and managerial convenience. In the context of energy policy, Helm (2004, p. 43) describes the situation as one where 'the public had been led to expect nationalised industries to take a wide account of the public interest – to include concepts of fairness to their workers and customers, to subsidise worthy causes, and to provide a public service. This meant showrooms in every town in Britain, sponsorship of research and development, and contributing to macro- as well as micro-economic objectives. The electricity industry even found itself as a 'commanding height' contributing to counter-inflation policies. The unwinding of these distortions has created the main difficulties of the transitions to more competitive conditions in the private sector, and the impacts will continue to live with us in the 21st century'.

Privatisation in the 1980s was thought to be the solution for these problems. The impetus for reform came from the expectation that access to private capital markets would free investment in infrastructure from the short-term spending constraints imposed by the Treasury; shifts in ideology that presented profit incentives, competition and regulation as engines of innovation and efficiency; and a desire to curb the power of the unions.

The 1980s inherited the infrastructure assets built by the public sector in the 1960s and 1970s, and saw a shift in the structure of the economy from manufacturing towards services. This meant that, at least in some areas (e.g. energy), demand for new infrastructure was relatively weak, and it remained so for a number of years. By the middle of the last decade, however, it became obvious that the new model was struggling to meet the surge in infrastructure needs that had in the meantime emerged.[60]

It became obvious that, in some important areas, the model created in the 1980s was failing to offer the private sector the type of long-term contract it required to invest. Facing the prospect of insufficient investment, the approach that successive governments seemed to have adopted is edging back towards the 20th century model of state intervention. There have been several steps taken in this direction, as Helm (2013, p. 303) explains.

> Subsidising the private sector, giving guarantees and state ownership – subsidies have now been advanced to water customers in the south-west on the grounds that they are no longer able (or politically willing) to pay; direct funding of broadband rollouts in rural areas has been provided; and direct ownership proposed for HS2. Indirect subsidies via levies on utilities have also become widespread. Guarantees have been advanced to Network Rail, and some £45 billion has been indicated for guarantees to some on the government's priority project list. Direct ownership applies in the case of London Underground and Crossrail.

The UK planning system

The English planning system is the outcome of an attempt to shape the spatial distribution of economic growth after the War and to tackle increasing concerns regarding the social and environmental impact of urban sprawl. Peter Hall (2004) offers an authoritative account of the historical process that led to the creation of the planning system as we know it today.

Between the two world wars the process of suburban growth sped up. Labour and building materials were cheap. The number of white-collar employees, with access to regular salaries and credit increased. These people began to aspire to buy a house of their own with the aid of a mortgage. Transport technology extended the effective commuting range by four

[60] Helm (2013, p. 287, 288) describes these demands. ‘In water, European directives have necessitated a clean-up of rivers and beaches, and a combination of weather events and building on flood plains has highlighted the inadequacy of flood defences. In energy, a combination of the ageing of existing power stations – built in the context of the industrial demand of the 1960s and 1970s – more European directives, and the decarbonisation agenda require a wholesale replacement of much of the existing capacity and, indeed, the electricity systems themselves. New smart technologies will bring added opportunities and pressures. The decline of North Sea gas reserves means new gas import pipelines and liquefied natural gas (LNG) facilities are required. Roads and railways require expansion, and high-speed rail requires a whole new network. Airport capacity in the south-east is inadequate, and Britain’s early lead in telecommunications has given way to a number of urgent and serious problems in broadband coverage and speeds. The combined total capital expenditure is of an order of magnitude greater than current investment.’

or five times, making a lot more land potentially developable and pushing down house prices.[61]

Town planners and rural conservationists voiced their concerns about the uncontrolled nature of urban sprawl. This, they claimed, created two perverse effects: first, development was using up valuable rural land (mostly agricultural land, causing a major loss of home food production, especially costly in times of war); second, it was harming townspeople, through increased congestion and commuting times. Representatives of the depressed industrial areas of northern England, south Wales and central Scotland expressed similar concerns, albeit for different reasons. In those regions, once-booming industries were now in steep decline, devastated by the effects of globalisation and technological change. At the same time, new industries were thriving in other areas (e.g. in London and in the Midlands). Government was compelled to take action, and in 1937 it appointed a Royal Commission on the Geographical Distribution of the Industrial Population under the chairmanship of Sir Anderson Montague-Barlow.

The Commission took the view that there was likely to be a causal link between the physical growth of great conurbations in the south and in the Midlands, and the economic hardship of the old industrial towns. It posited that 20th-century industries would tend to gravitate towards very big population centres,[62] where a wide range of labour skills and specialised services were available. If continued, this trend would leave large concentrations of people and capital stranded in the smaller towns. The Commission also concluded that the disadvantages of living in large urban concentrations outweighed any advantages, and demanded specific government remedies such as controls on the location of new industry. The Commission also called for further expert studies to consider creating a planning system that allowed a more effective control of the physical growth of cities and conurbations. Follow-up studies were conducted between 1941-47 and laid the foundations of the post-War urban and regional planning system in the UK. Powered by a strong, post-War, reformist impetus, their recommendations were swiftly turned into legislation from 1945 to 1952.[63]

In theory, the bulk of urban development and redevelopment was to be carried out by public entities, including local authorities and new towns. They would be responsible for urban regeneration programmes and the construction of new and expanded towns in the countryside. Negative powers of control would be necessary only to control a minority of developments that would still be carried out by private initiatives. Population and economic growth were expected to be slow. The plan was to control and regulate the pace and direction of social-economic and physical change.

In practice, things proved to be different. In the half-century after the Second World War, the UK experienced demographic and economic change on an unprecedented scale. A

[61] Land and house prices reached a low point in relation to income in the 1930s, never equalled before or since.
[62] Older industries had been attracted to places where fuel and raw material supplies were abundant and where there was navigable water. But the new industries were much less dependent on these technological conditions.
[63] A series of acts – the Distribution of Industry Act 1945, the New Towns Act 1946, the Town and Country Planning Act 1945, the National Parks and Access to the Countryside Act 1949 and the Town Development Act 1952 – formed the post-War planning system. Many of the features of these acts are still active to this date.

combination of fast population growth,[64] increasing levels of mobility and rising prosperity,[65] undermined the theoretical foundations of the post-war planning model. To aggravate matters, lack of co-ordination of local plans left local authorities pursuing mostly defensive, negative planning policies[66] while weak financial provisions hindered plans for expanding existing country towns.

The result was that the trends of the interwar period continued after the War: population moving into the great urban regions, and simultaneously out of their congested inner areas and into the suburban fringes.

The census showed that population growth in the ring [of Home Counties around London] during the 1950s had amounted to 800,000 people – one third of the net growth of population in Britain. And contrary to the expectations of the architects of the 1947 system, the vast majority had been housed not in planned new or expanded towns, but in privately-built suburban estates on the familiar interwar model. The only change was that the green belt had been held; the developers had therefore leapfrogged it, pushing the zone of rapid population growth into a wide band up to 50 miles (80 km) from the centre of London. And, over the succeeding decades, this urban frontier would move progressively farther out (Hall, 2005, p. 107).

[64] This was combined with steady decrease in the size of households: the product of earlier marriages, young people leaving home in search of educational or job opportunities; and a tendency for retired people to live by themselves in seaside colonies.

[65] Durable consumer goods became acceptable to the masses, creating demands for more usable space in and around the home.

[66] When the planning system was designed, it was widely accepted that the right unit for spatial planning was the urban region. The 1947 Act gave the local planning powers to the local authorities, but it provided for co-ordination by requiring that plans be submitted to the minister for approval. To inform these decisions, the Ministry of Town and Country Planning had strong regional offices in each of the main provincial cities. But during the 1950s these offices were closed down for reasons of economy, and at this point the idea of co-ordinating the various local plans seems to have been more or less abandoned.

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