7

Conclusion

The fundamental claim of this book has been just this: that more responsive political systems – ones that shift the most power in response to the smallest changes in voter sentiment – empower consumers. The less the distribution of power responds to voter sentiment, the more powerful producers will be. And because producers readily conspire to inhibit competition, that power expresses itself in anticompetitive policies: barriers to entry, regulated prices, local or niche-market monopolies. Although we have focused on one (we believe) particularly compelling bit of evidence, namely the link between electoral systems and prices, our more basic point has many further implications, some of which we outline here as an agenda for further research.

If our basic point is right, electoral systems must be endogenous (as Acemoglu [2005] has argued, and as we have tried to show in Chapter 6): Neither voters nor politicians (let alone lobbyists) are fools, and they understand (if only intuitively) a great deal of what is at stake. Yet crucial political institutions are "sticky," indeed often constitutionally anchored, and we will follow convention in positing in the first part of our discussion here that the electoral system is exogenous. So what, beyond higher prices, does a *less* responsive electoral system (in most cases, PR) entail? At a minimum, we argue, quite different modes of political action and organization, different fiscal systems, and consequently different policies.

If Institutions Are Exogenous

Political Organization

(1) Because votes make little difference, lobbyists in PR systems will not seek to influence voters directly: they will waste few resources on the kinds of **political action committees** that try to sway Americans' or Britons' votes.[1] Rather, lobbyists will contribute directly to parties or politicians, or will seek elite influence predominantly by other channels (charities, lavish entertainment, spectacular events, nepotism).

(2) Just as "the tariff was mother of the trust" (as nineteenth- and early twentieth-century radicals put it), so the availability of pro-producer policies under low-responsiveness government stimulates and preserves **powerful producer organizations**: at the sectoral level, the national

[1] We owe this insight to David Laitin.

level, or even (e.g., within the European Union) supranational level – or sometimes all three at once. Low-responsiveness politics engenders strong organizations of both owners and workers and encourages labor-management cooperation ("corporatism") that both ensures monopoly profits and guarantees a "fair" division of those profits. So strong do these organizations sometimes become that major political parties are often mere coalitions of interest groups (e.g., Germany's Christian Democratic Union in its formative years: see Domes [1964]).

Higher Wages, Greater Equality, Better Training

(3) In democracies, low-responsiveness politics and resultant anticompetitive policies serve (somewhat paradoxically) to **strengthen labor, raise organized-sector wages, and reduce economic inequality** – although the reduction in inequality holds only among "insiders" (more on this later) and fades in the face of immigration or global cheap-labor competition.

PR's disempowerment of voters and encouragement of strong organizations helps all producers (certainly including managers) but actually helps labor more. Once both management and labor are strongly organized, unions easily become the dominant "social partners," capable both of disrupting the economy and (at least where centralized) of commanding a bloc of votes big enough to affect outcomes even in low-responsiveness systems. The powerful unions then win higher wages[2] (especially for the more numerous low-skill workers), either at the direct expense of consumers (in trade-sheltered sectors) or indirectly via higher social benefits (in sectors where international competition inhibits pass-through of higher costs to consumers). The end result, at least where much of labor is organized, is (as argued earlier) **greater economic equality**.

(4) Once achieved, monopoly profits and high wages can be sustained (i.e., not competed away) only by erecting elaborate **barriers to entry**: daunting technical qualifications, long apprenticeships, restrictive licensure.[3] On this, workers and owners find common ground: difficult qualifications and licensure both restrict the supply of new workers and (if training is good) assure employers that new workers' marginal product will more closely approximate their high wage. Thus it is not so surprising (e.g., in Germany) that unions and employers have repeatedly been able to renegotiate and preserve the elaborate training systems that guarantee a highly qualified (and quite expensive) workforce (Thelen 2004, chaps. 2 and 5).

[2] More precisely: wages that exceed the relevant workers' marginal product, i.e., that must somehow be subsidized.

[3] We do not at all exclude the possibility that the preexistence of strong producer organizations (e.g., guilds) predisposes a country toward PR (cf. Cusack, Iversen, and Soskice 2007). We take up this theme in earnest when, later, we begin to treat the electoral system as endogenous.

(5) More darkly, the barriers to entry usually guarantee **insider-outsider** distinctions (Rueda 2005, 2007) and significant **gender and ethnic discrimination**. The benefits to labor under the pro-producer regime go only to *organized* workers, creating a classical "dual labor market" and actually pushing down wages in any unorganized branches. As some close students of "organized market economies" have noted, too often unions and employers can agree that the high training costs of a long and demanding apprenticeship would be "wasted" on women (too likely to interrupt their careers for family reasons); hence the high-skill, well-paid workforce tends to be overwhelmingly male, while women are consigned (even in professedly egalitarian societies) to the low-wage, unorganized sectors (Estevez-Abe, Iversen, and Soskice 2001). A similar logic can be used against "less reliable" minorities, or ones who may objectively be more likely to return, temporarily or permanently, to their homelands, and thus to "export" any investment in their human capital.

Consumption Taxes, Inefficient Retailing

The disempowerment of consumers in low-responsiveness systems is expressed baldly in two kinds of policies: A strong bias toward **taxes on consumption** rather than on labor (income) or capital (property, capital gains, corporations); and toleration, indeed legal protection, of **extremely**

inefficient retailing (small shops, local monopolies, restricted opening hours, retail price maintenance, etc.).

(6) Owners reject taxes on capital and corporate income; managers oppose highly progressive income taxes; workers dislike taxes on labor. All producer groups can agree on **taxing consumers**, provided only (a) that the sums raised finance social benefits (which flow mostly to workers) and (b) that sales abroad (exports) are not taxed.[4] While it is also the case that well-structured consumption taxes (e.g., a value-added tax) are less distortionary, particularly in highly trade-exposed economies, even controlling for these effects we expect less responsive political systems to derive a higher proportion of government revenues from taxes on consumption.[5] Or, to put it the other way around: to the extent that a responsive political system empowers consumers, they will have the "clout" to minimize taxes on consumption.

[4] The pioneering and absolutely indispensable article on this point (which happens also to be consistent with our argument here) is Baramendi and Rueda 2007.

[5] Of twelve OECD countries on which effective tax rates on consumption are available for 1995, six happened to use PR and six majoritarian electoral systems. Among the PR systems, effective tax rates on consumption ranged from 16.7 to 32.9 percent, with an average of 24.6 percent; the majoritarian systems ranged from 5.6 to 19.9 percent, with an average of 13.2 percent (Baramendi and Rueda 2007, 622, table 1). The alert reader may now wonder whether consumption taxes do not account for all of the price differences that we observe between PR and majoritarian systems. They do not. We have rigorously checked for this possibility at earlier stages of our research, e.g., in Chapter 3.

(7) Offered the identical product at radically different prices by two otherwise equal retailers, the rational consumer will always choose the lower price: indeed, in strict competition theory the higher-price retailer will wind up with zero sales. Hence, competitive retailing leads repeatedly to radical improvements in efficiency that permit innovative retailers to offer the same goods at lower prices: The mom-and-pop store yields to the supermarket, the supermarket to Wal-Mart; and each wave has granted consumers the same (or better) goods at ever-lower real prices.[6] Governmental policy however can spur, retard, or prohibit competition in a hugely inventive variety of ways, from strict regulation of interstate trucking or banking (the United States for many years) or airlines (most countries until the 1970s), to grants of local monopolies to bakeries and pharmacies (Germany until quite recently), to restrictions on the physical size of shops (France), the number of outlets that any one firm or individual can own (German pharmacies), the hours during which stores may be open for business, the prices they may charge (German bookstores), or the wages their sector must pay ("privatized" German postal delivery). More recently, barriers have gone up

[6] Typically, the arrival of a Wal-Mart store in a community "reduces consumer prices for food by fully 25 percent, of which 20 percent is the direct Wal-Mart impact and the other 5 percent represents the response of local stores to the Wal-Mart arrival." Hausman and Leibtag 2004, as cited in Gorden and Dew-Becker 2008.

against Web-based retailing, particularly from extraterritorial sources (Canadian online pharmacies in the United States, Dutch ones in Germany).

Retailers, like most humans, prefer a predictable and comfortable existence, hence (see again Adam Smith) are always eager to ban precisely the kind of "cutthroat competition" that spurs innovation and lowers retail prices. Producers are at best indifferent, or – where, as with Wal-Mart, aggressive retailers use their market power to demand wholesale price cuts – actively sympathize with the more traditional retailers. Only consumers fully benefit from retail innovation. Thus, where low-responsiveness political systems restrict consumers' influence, policy remains strongly anticompetitive, retailing retains ancient inefficiencies, and retail prices (depending on the extent of the restriction) range from high to extortionate.[7]

Concretely, then: We expect that, under low-responsiveness electoral systems, retailing will remain a particularly inefficient, highly regulated, and high-cost sector. Any shift from PR to a majoritarian system will tend to produce more competitive and efficient retailing; any shift from a

[7] Many non-Europeans have experienced the literal headache of discovering that the same over-the-counter painkillers that retail for about 2 U.S. cents per tablet in much of the world cost about twenty times that much in highly regulated European pharmacies.

majoritarian system to PR will quickly induce more regulation, less competition, and greater inefficiency.

Longer Time-Horizons, Better Infrastructure

(8) On the brighter side, and as others have noted, low-responsiveness systems, precisely by shielding politicians from shifting currents of popular opinion, allow leaders **longer time-horizons** and **greater intertemporal credibility**. Thus PR systems, if securely in place, create a more favorable environment for long-term infrastructural investment. Just as James Rauch (Rauch 1995) has found among U.S. cities, governmental systems that assure leaders longer and more secure tenure (in that case, professional city-manager systems) lead to markedly greater investment in appropriate infrastructure (streets, sewers, harbors, airports) and hence, all else equal, to greater investment and growth; so low-responsiveness systems, for all their disadvantages in competitiveness and prices, should lead (or so we hypothesize for future research) to more and better infrastructure, and (perhaps) to the kind of policy commitment that reassures investors.[8]

[8] All else equal, the better infrastructure should lower costs, but in an anticompetitive environment this simply increases oligopoly slack rather than lowering prices.

Summarizing our discussion so far: If we could take political institutions, and in particular the electoral system, as exogenous, our model would lead to the further implication that low-responsiveness systems would inspire:

- a higher degree of political organization,
- a style of lobbying centered on parties and leaders rather than on voters,
- higher wages, far more emphasis on workforce training and qualification, and (until low-wage international competition becomes significant) greater equality;
- at the same time, greater discrimination against women and minorities;
- greater reliance on consumption taxes
- greater regulation of, and inefficiency in, retailing; but also
- greater investment in infrastructure.

All of this (and more) would follow if institutions were completely exogenous, and in the short term, they may ordinarily be taken as such. Institutions can, however, be changed – in some cases by simple law, in others by supermajority or constitutional amendment, in extreme cases by coup or revolution – and sometimes are (in some countries more readily than others[9]). Even in the most conservative

[9] Fourth Republic France, even in its short existence, became notorious for frequent, and tactically motivated, changes in its electoral system. The

democracies, however, dysfunctional institutions generate strong incentives for their own change, rewarding the political entrepreneurs whose reforms can reduce inertial and deadweight costs. And, of course, interests within each system seek institutional changes that will benefit them. If, in this light, we admit that over the longer run institutions are shaped by social forces – but bearing in mind the shorter-term effects we have outlined previously – we must now consider variables that will affect the institutions a country adopts and retains.

Admitting that Institutions Are Endogenous

Preexisting Strength of Producer Organizations; Major War, Country Size

(1) Where producers were, for whatever reason, already highly organized at the inception of democratic institutions, or where some external shock greatly strengthened them, low-responsiveness, pro-producer institutions – particularly the combination of PR and parliamentarism – were much likelier to be adopted and retained. Thus, as many previous students have noted, PR came more easily to countries with a history of **strong guilds**, strong trade unions, powerful employer associations, or (most favorably of all) centralized wage bargaining

recent vacillations in the Italian electoral system have been outlined in Chapter 5.

that brought most of these players regularly to a common table (see, among many others, Katzenstein 1985; Verdier 2001, 2002; Hall and Soskice 2001; Cusack, Iversen, and Soskice 2007). And, of course, the countries that further strengthened these economic institutions under PR-parliamentary government were all the likelier to retain precisely that system.

(2) From this standpoint, the timing of PR's widespread adoption in the years during or immediately after **major wars** (in particular, World War I) makes eminent sense. Major war – certainly among the belligerents, and to some extent even by its effects on neighboring countries – itself creates much stronger producer organizations to manage and discipline the wartime economy: Unions, industry-wide associations, transportation networks – all are integrated into the war effort but at the same time greatly strengthened (even in so unlikely a case as Imperial Germany in World War I; Feldman 1966).

(3) This perspective, we submit, just as simply explains the frequently observed fact that **small countries** more readily adopt and retain PR (Katzenstein 1985). Given the diseconomies of scale in organization (Wallerstein 1989), smaller countries will be more highly organized – not only in trade unions, but in virtually all sectors; and these strong producer organizations will back low-responsiveness, pro-producer institutions. This should be true even when one controls (as we have done in our empirical work) for the extent of

countries' dependence on foreign trade – which tends, of course, to be greater in smaller countries (see further discussion of the trade issue later).

This insight has an important dynamic implication, particularly relevant given recent history: When a smaller country is carved out of a larger one (e.g., by breakup or secession), the new smaller entity is more likely (albeit perhaps with some lag) to adopt PR.

Preexisting Equality

(4) As argued in Chapter 6, PR-parliamentary institutions are likelier to be adopted and retained in societies that – controlling for such aspects as guild history and country size, just mentioned – already exhibit a **high degree of equality** in income and ownership. At least two further reasons are involved: (a) As noted earlier in this chapter, low-responsiveness institutions, by encouraging or reinforcing organizations of workers, tend themselves to have a strong equalizing effect, one that looms as too big a threat to elites in highly unequal societies (cf. Boix 2003). (b) As argued elsewhere (Rogowski and Macrae 2008), as society grows more unequal, PR represents less well the interests of the mean voter, thus likely further reducing social welfare. To put the same point the other way around, the welfare loss from PR is less the more equal the society.

Openness to Trade

(5) The more easily any good or service is traded cross-nationally, the more will the "Law of One Price" obtain: Gold, to take the classical example, commands almost exactly the same real price in every national market, while bricks or haircuts – both extreme examples of nontraded goods – can vary substantially in real price in different countries, and indeed in different locales within countries. And countries themselves differ in their openness to foreign trade, for reasons both of policy (some are more protectionist) and of natural endowment (some have porous borders or natural harbors, others are landlocked or rimmed by almost unsurpassable mountains). Thus, all else equal, anticompetitive arrangements and high real prices will prove harder to defend in those countries (and, as well, in those sectors within countries) characterized by the **greatest share of foreign trade in production and consumption**. And this is exactly what our empirical work has shown: controlling both for country size (which of course is inversely related to trade openness, i.e., small countries tend to trade more) and for political institutions, we find consistently that greater openness to foreign trade is associated with lower real prices, that is, the international market forces "world" prices onto countries and sectors that are more open.

For us, this raises the interesting point of a possible link between "globalization," or increasing openness of economies, and both anticompetitive policies and nonresponsive institutions. While it is historically true that many countries (particularly small ones) with a high degree of exposure to foreign trade have adopted and retained low-responsiveness institutions, our own conjecture – although, at this point, it is only that – is that such institutions will come under increasing pressure as exposure to international competition affects more and more of their sectors. To reduce this conjecture, finally, almost to a slogan: *globalization ultimately undermines PR* (and similarly less responsive institutions).

Summing up, again: When we view institutions as endogenous, we find that one "inherited" factor and four "changeable" ones affect the likelihood that low-responsiveness institutions will be adopted or retained. The major "inherited" factor favoring PR is:

- a history of strong guilds.

Another, frequently taken as inherited but proven by recent history to be changeable, is:

- small country size.

Two clearly changeable factors favoring PR, which taken together can explain many of the electoral system changes over the last century and more, are:

- major wars and
- greater equality.

The last changeable factor, which ultimately (we conjecture) undermines PR, is:

- **openness to international trade**, or (in its dynamic sense) "globalization."

Since at least the 1860s, students of politics have investigated and debated the effects of electoral systems. More recently, the spotlight has turned to these systems' impacts on governments' economic policies, including particularly their propensity to expand public spending and to inflate the currency. Much more recently, indeed only over the past decade or so, scholars have turned their attention to the possible causes of electoral systems, and in a few cases[10] have begun to think through the possibly reciprocal relationship between electoral and economic system. Part of that overall consideration, in our view, must be the reciprocal link between political institutions and (a) the producer-consumer balance, or (b) the extent to which policy favors, or inhibits, competition. This book, we hope, has advanced precisely that aspect of the overall discussion.

[10] The most important contributor here has been Torben Iversen, together with various coauthors.