Edited by R.C.O. Matthews

ECONOMY AND DEMOCRACY

The other contributors

Vani Borooah · Keith Cowling
John Eldridge · Ralph Harris
Peter Jackson · Michael Lipton
Anthony Ogus · William Rodgers
Charles Rowley

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Ralph Harris has been General Director of the Institute of Economic Affairs since 1957. He was educated at Tottenham Grammar School and Queen's College, Cambridge, and lectured in political economy at St Andrews University from 1949 to 1956. He has lectured and written extensively on the failure of successive governments to achieve their declared economic objectives. In 1979 Ralph Harris was created a life peer.

Peter Jackson is Professor of Economics and Director of the Public Sector Economics Research Centre, University of Leicester. His publications include *The Political Economy of Bureaucracy* (1982).

Michael Lipton is Professorial Fellow of the Institute of Development Studies at the University of Sussex, and a Fellow of All Souls College, Oxford. He works mainly on the economics of tropical agriculture and rural development in South Asia and Africa. His work includes *Why Poor People Stay Poor: Urban Bias in World Development* (1977).

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Robin Matthews is Professor of Political Economy and Master of Clare College, Cambridge. He was previously Drummond Professor of Political Economy in Oxford and is currently President of the Royal Economic Society. He is the author of many books and articles, particularly on the history and theory of growth and fluctuations and, more recently, on the psychological and institutional underpinnings of competitive economic systems. In 1972–5 he served as Chairman of the Social Science Research Council.

Anthony Ogus is Professor of Law at the University of Newcastle-upon-Tyne. He is the editor (with C. G. Veljanovski) of *Readings in the Economics of Law and Regulation* (1984) and has written widely on topics including law and economics and the law of social security.

William Rodgers is Vice-President of the Social Democratic Party. He was Member of Parliament for Stockton-on-Tees from 1962 to 1983 and served as a Minister in both the 1964–70 and 1974–9 governments, latterly in the Cabinet. He was one of the 'Gang of Four' who founded the SDP in 1981. He is the author of *The Politics of Change* (1982).

Charles Rowley graduated from the University of Nottingham with first-class honours in 1960 and a PhD in 1964. He has been a Lecturer at the Universities of Nottingham and Kent and a Senior Lecturer at Kent. He has also been a Reader at the University of York. From 1972 to 1984 he was David Dale Professor of Economics at the University of Newcastle-upon-Tyne. Professor Rowley has published in the fields of welfare economics, public economics, public choice, law and economics and industrial economics. He is now Professor of Economics at George Mason University.

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Introduction

R. C. O. MATTHEWS

This book is about economy and democracy. It is therefore about public choice and competition; for in a political democracy with a market economy we expect to exercise our vote with respect to our leaders and our parties as well as our beavers and our deer. Our choices in the political market are particularly significant in a country such as Britain where the State plays so active a role in economic and social life.

Because this book is about economy and democracy, it is about markets and competition. Competition serves as some safeguard against inefficiency and exploitation; and in my own paper I distinguish two types. Most familiar in economics is competition-in-transactions, where buyers compete with buyers and sellers with sellers. More familiar in politics (though not confined to politics) is competition-for-authority, where there are rival aspirants to authority within an organisation (such as the State). Neither type of competition works perfectly. The peculiarity of competition-for-authority, for example, is that it is all-or-none: the winner typically takes all, which can cause his policies then to diverge considerably from the wishes of the electorate (to say nothing of minorities, which remain unprotected). Business competition can lead to monopoly; unrestrained political competition can enable the winner to rig or cancel subsequent elections (the phenomenon of one man one vote – once); but correctives do exist (international trade in the case of economic competition, consensus and moderation in the case of political competition), and moreover *some* competition is better than *no* competition at all.

The parallels and interaction between political and economic behaviour are explored further in the paper by Vani Borooah, who supports his theories with empirical evidence relating to the British experience in the period 1955–9. Borooah initially analyses the proposition that a government's economic policies and performance significantly influence its electoral popularity. He finds some empirical support for this hypothesis, but notes that there is some debate among investigators about the nature of the economic factors that concern the electorate (not least because different voters of different class and social backgrounds are vulnerable to different aspects of the economy and hence have different economic interests) and about the stability over time of the popularity/performance relationship. Dr Borooah also examines the possibility of governments' manipulating policy in order to seek electoral advantage. After reviewing theories of politically-motivated economic policy-making, he concludes that these theories are not relevant for an understanding of the British experience in the last two decades.

Borooah's conclusion – that there is economic and political life beyond self-interest narrowly understood – is reassuring in the light of the conflicts to which Michael Lipton draws attention in his contribution. Lipton points out that in many real-life situations (and not exclusively in the Third World countries with which his paper is explicitly concerned) if each person acts in his own best interests, the result will be fairly bad for all persons taken together: the sea will be over-fished, taxes will be under-paid, the towns will be over-crowded. If each party acts *as if* all were prepared to cooperate, then there is an acceptable outcome for all. For each, however, self-interest narrowly understood dictates that the best result is to get away with greed (via over-grazing or tax evasion, for example) while the others exercise restraint. There are two 'parables' describing how such conflicts might be resolved – Coase's Theorem and the Prisoners' Dilemma – and Lipton, after examining these parables, reaches the following conclusion: democratic political systems are likely to represent the most promising (and least costly) way of achieving general agreement on the moderate degree of altruism and internalised values necessary to avoid conflicts of interest associated with the problem of free riders.

Bill Rodgers, approaching the topic of this book from the standpoint of a practical politician, welcomes such a defence of democracy. His own paper, indeed, indicates a belief in the increasing efficiency of the political market in Great Britain. Voters, he says, now show sophistication and rationality (as opposed to tradition and knee-jerk loyalty) in judging the alternatives offered to them by political parties. Again, voters now look beyond immediate self-interest and have a growing understanding of the external factors that constrain a government's freedom for manoeuvre. And members of Parliament, he reports, cannot realistically be regarded either as selfish careerists or as doctrinal zealots: public service and a sense of moral imperatives play their part. As with any market, however, the political market is subject to change and process; and his views on the case both for the supplying of a new product (to satisfy the potential demand on the middle ground) and for a new mode of payment (proportional representation) are stimulating and at the same time controversial.

Not all of our leaders and decision-makers are, of course, elected. Some are appointed; and it is with the interface between law and economics that the papers by Charles Rowley and Anthony Ogus are concerned. Rowley, welcoming the multiple bridges now being built between the law and economics and the public choice schools, draws attention to the impact on economic affairs of the decrees and not only of politicians but of judges as well. He refers to the extensive legal immunities in tort and in contract that have been conferred in the United Kingdom on trades unions and their leaders and speaks with obvious reservations of the manner in which such rent-seeking behaviour has been validated in the court-room. Anthony Ogus, continuing the theme of law and economics (with particular reference, in his case, to the demand for compensation), argues that theorists have seriously exaggerated the differences between judicial and legislative processes. Judicial rules, he says, are not necessarily (economically) efficient, and statute law (despite the well-known argument that legislation is primarily a response to the demand by influential pressure-groups for benefits) is not necessarily inefficient. Judges respond to moral ideals and distributional objectives as well as to considerations of allocative efficiency; legislators (while seeking perhaps to preserve power through the granting of rights to compensation to those with electoral power to pay for them) create rights which affect distribution and efficiency as well; and too radical a divorce should therefore not be posited between the work of the British courts and the British Parliament.

There is, apart from judges, another group of non-elected decision-makers who exercise an influence on economic affairs, and that is bureaucrats. Peter Jackson, in his paper, examines the possible goals of bureaucrats (ranging from job-satisfaction to maximisation of the size of the bureau and its budget) and asks the fundamental question about the accountability of the organisation-man. He finds no single solution to the undeniable problem (especially in highly centralised systems) of bureaucratic inefficiencies; but he warns that privatisation does not necessarily discipline the man on a fixed income, and indicates the need for greater scrutiny and greater freedom of information. His model, as it happens, is the usual Weberian one of hierarchy; and, as John Eldridge reminds us, an alternative model of men in organisations is one of which the centrepiece would be consultation, cooperation and participatory decision-making. Eldridge would accept that employee involvement is not a solution to the problem of accountability but would stress that trust and improved morale can make a considerable contribution to the internal efficiency of a bureaucratised organisation. His essay is particularly interesting in the context of *Economy and Democracy* because of its concern with democracy *within* economy.

The final two chapters of this book – those by Ralph Harris and Keith Cowling – look to the future and make recommendations for reform. It would be fair to say that these two authors are not always in complete accord. They cannot both be right. Is either? Ralph Harris, on the one hand, argues that government should be tamed. Since the war, he says, governments of all parties have expanded the scope of government far beyond its essential functions of supplying public services and of topping up low incomes so as to enable all to satisfy their needs in the market-place. The net result, he asserts, is a system detrimental to adaptation, allocative efficiency, growth, individual freedom and personal responsibility – a system which should therefore be replaced by one which relies more extensively on the market. Keith Cowling, on the other hand, argues that full democracy implies equal participation for all in *all* aspects of society, and that capitalism must deny such equality within the economic arena. A fundamental antagonism therefore exists, in his view, between capitalism and democracy, an antagonism which is obscured but not eliminated by the existence of universal suffrage. While accepting the importance of universal suffrage and even the possibility of further gains within the present system, the paper suggests none the less that further democratic advance will ultimately require a transformation in the capitalist economy itself.

The no-man's-land between economics and politics was long regarded as barren and unfruitful and was left uncultivated. The truth is that political economy *matters* and that the no-man's-land has the potential to become a productive field for research and debate. It is hoped that the present volume will make a genuine contribution to such investigation and speculation.

Contents

1 Competition in Economy and Polity[1]

R. C. O. MATTHEWS

1. TWO OBJECTIVES AND TWO TYPES OF COMPETITION

I propose to define competition as a situation in which two or more people or groups of people are vying for the favours of some person or groups of persons, who thus act as arbiters between them. From the point of view of the arbiters, the existence of competition means the existence of choice between people – a particular case of choice between options. In a competitive market, characterised by voluntary exchange, the arbiters are typically the other parties to the exchange: the buyers are arbiters between the competing sellers and *vice versa*. In political elections, the arbiters are the voters. Competition is a particular kind of contestation. It is not the only kind. Anything in the nature of a two-person game is excluded, as not being contestation for the favours of a third party. Thus a fight or a race, real or ritualised, does not rank as competition on the present definition. Nor does bargaining, as such, though bargains, particularly bargains about the formation of alliances, may be an important tactic in competition.[2]

The antithesis of economic competition is monopoly or monopsony. The antithesis of political competition is autocracy. Political competition is not, however, identical to democracy. Political competition is compatible with a very restricted franchise, and, on the other hand, democracy may take the form of direct voting on issues rather than of choice between people. In practice, the scope for direct democracy in political affairs is extremely limited, so competition is a necessary condition for democracy, though not a sufficient one.

There are two purposes for which the existence of competition is commonly regarded as desirable: to prevent inefficiency and to prevent

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exploitation. Inefficiency is about being off the contract curve, being in a situation where potentially everyone is worse off than he might be. Exploitation, as normally understood, is about distribution. A monopolist or a political autocrat is in a position to enforce a distribution of the gains from production and exchange, or the gains from the exercise of government power, that is unduly favourable to himself or his friends. I propose to use the term exploitation in an extended sense to include also the imposition of an unwelcome ideology; I will be saying more about that later. Inefficiency and exploitation may go together, as in the cases of the textbook monopolist and the corrupt official, who carry out exploitation by means that involve allocative inefficiency. Conceptually, however, inefficiency and exploitation are separate. Inefficiency of the X-efficiency type may be disadvantageous even to its practitioners. Exploitation may be practised without X-inefficiency and without allocative inefficiency (as by the perfectly discriminating monopolist).

Neither inefficiency nor exploitation is an unambiguous concept. In a general way, however, it is easy to see that both represent something that may be objected to and that the danger of both is present in both economics and politics, though not necessarily to the same degree.[3] The way in which competition may cause the dangers to be less than they would be in its absence is also obvious. If you are inefficient, competition will reduce the sphere of your operations or cause you to be displaced altogether. Before that stage is reached, moreover, competition provides a source of information: loss of ground to a competitor warns you that your performance leaves room for improvement and it may also signal to you where improvement is needed. As regards exploitation, competition provides an alternative person to deal with if the present one seeks to arrogate too much advantage to himself.

These are the *prima facie* arguments in favour of competition. Of course, competition cannot do everything. In the first place, competition is a supplement to rational optimisation, including bargaining, not a substitute for it. Indeed, one of the purposes of competition is to give greater weight in the system to people who have more than average skill in exercising rational optimisation. In the second place, competition may be compatible with inequalities that many people would regard as exploitative and with manifold inefficiencies. In addition, competition does have costs, and these may sometimes make competition undesirable or even impossible. To quote examples: no one (or hardly anyone) advocates competition within society in the use of armed force; competition would lead to waste of resources if economies of scale create natural monopolies; monopoly may be better than competition if the other side of a class of transactions is going to be monopolised anyway (countervailing power). Finally, competition may be destructive of mutual trust. This is an argument that we view with suspicion when it is advanced as a pretext for the establishment of a one-party state, but we have more sympathy for it as a justification for tenure in academe and in marriage. In cases where competition has these or other costs, its advantages have to be weighed against its disadvantages. The question is not whether competition works perfectly, which it never does, but whether it works better than the absence of competition, which it will do in some cases and not in others.

Competition may be more or less severe. Moreover, it can take various forms and they will not all have the same effects. For example, it may or may not be oligopolistic. The distinction between types of competition that will be central in this address is the following. Competition of the kind that is most familiar to economists is competition between rival individuals or organisations in their transactions with third parties – competition, say, between firms for labour or for customers. The favours competed for are the opportunity to do business with the arbiter. I shall call this *competition-in-transactions* (CT). The private sector of the economy is the most characteristic stamping-ground of CT, but it also affects the state: only in the most totalitarian states does the government use its powers to exempt itself from all CT – most governments are content to hire labour and buy supplies in competition with other economic agents. CT may be contrasted with *competition-for-authority* (CA), which is competition between rival claimants for the right to wield authority within an organisation. CA is characteristic of political competition. However it is not confined to competition for control over the ship of state. CA takes place in innumerable private organisations – not only in political parties, where it is a crucial part of political competition, but also in joint-stock companies, in trade unions, in charities and other non-profit bodies, in fact in all institutions that rank as clubs in the sense of Buchanan. Hence the distinction between CT and CA is not the same as the distinction between competition in the private sector and in politics. However, the state in the exercise of its most distinctive domestic functions is not subject to CT, so if competition is to be a safeguard against the twin dangers of state inefficiency and state exploitation, it is CA that must be mainly relied on.

CA can take a great variety of forms. Indeed, one of the most striking features of competition for political authority as it actually exists is its extreme complexity and diversity, even within democratic countries. One was brought up to regard the Westminster model as a paradigm, but in fact only in New Zealand (the most British of overseas Commonwealth countries) are the arrangements at all closely similar to our own. Likewise in reading the public choice literature, mostly of American origin, one is continually struck by how much of it is inapplicable without considerable modification to countries other than the United States, which is even less typical than our own. There exists in democratic countries an endless variety of relations between the executive and the legislature and the electorate, of voting systems, of party structures and so on. Similar variety exists in the forms of CA in private bodies, in the amount of authority conferred and in the relations laid down between the various persons and sub-bodies involved. CT, by contrast, is a good deal more similar everywhere, at least in formal arrangements.

One naturally thinks of voting as the means by which CA is conducted, but it is not the only one. CA may be carried out by market means, as in takeover situations. However, overt use of the price mechanism in CA is exceptional, apart from takeovers. We do not observe what would be the most direct form of price-CA, namely offers to do the job for less pay. Price does not equate supply and demand for authority. Access to authority is always quantity-constrained. On the other hand, a bargain with an effect similar to price-cutting occurs in the quite frequent case where candidates try to broaden their support by offering a share of office or influence to some other individual or group, thereby diluting their own return from success in the competition. Contests for authority may also, of course, be conducted by means that are not competition in the sense of being determined by arbiters' preferences. Bargaining between management and unions over the right to control work practices is a case in point. Civil war is another.

CA implies, by definition, the existence of *organisations*. If all decisions were made by atomistic individuals, the question of authority would not arise. The characteristic of organisations is that they have a machinery for making collective decisions. An organisation without such a machinery would be a contradiction in terms. There is endless scope for variation in the composition of the body that exercises the collective authority and in the scope of that authority, but at the least there must be agreement by members, enforced by threat of some form of sanction, to abide by the decisions that fall within its purview. To that extent the existence of authority in organisations is inherent; and in any but the very smallest organisations (such as the family) the authority is bound to have a hierarchical character.

A large part of this address will be concerned with comparisons between these two forms of competition, CT and CA, characteristic, though not exclusively so, of economics and politics respectively. I should note that the line between CT and CA is not always perfectly sharp. Grey areas include, for example, competition for promotion within hierarchies and competition between organisations for members.[4]

As far as inefficiency is concerned, the safeguards afforded by CT and CA are those already mentioned as resulting from competition generally. The main role of CA in this regard is to assist towards effective optimisation, given that rationality is bounded: it helps to ensure that those entrusted with the difficult tasks of decision-making are suitable to do so and are not incompetent or indolent or dishonest or too old (gerontocracy is a common failing of autocracies, both public and private). The position regarding exploitation is rather different. How far CA provides a safeguard against exploitation depends on how broadly representative the competitors and the arbiters are of all those who are members of an organisation or are affected by its operations. Active CA among a very restricted group in an organisation may, besides checking inefficiency, prevent members of that group from exploiting one another. However, it will not have any tendency to prevent the group as a whole from exploiting everyone else. Thus, in the case of the state, democracy is more of a safeguard against exploitation than oligarchy is, even though both involve CA.

In private organisations the authority that people compete for is not absolute. It is confined to the affairs of the organisation, for a start. Moreoever, while it is convenient, and indeed essential, for the members of an organisation to entrust many decisions to the management, it is customary to reserve some classes of decision for direct voting by members of the organisation – for example, alterations in a company's Articles of Association. As far as those decisions are concerned, the members prefer to collectively carry out their own optimisation rather than to proceed indirectly by competitive choice of delegates with discretionary authority.

As this example shows, not all voting ranks as CA, or indeed as competition at all in the sense of choice between people. Likewise in a committee where the members are agreed on objectives and confer together in order to share information and decide the best course of action in face of uncertainty, voting less resembles competition than it resembles the weighing up of alternatives that goes on in the mind of a rational individual, i.e. optimisation. This is still the case if the source of disagreement between the members lies in divergence of interest rather than divergence of opinion, so that their debate has the character of bargaining. The comparison with the rational individual still holds up to a point, since the individuaal too has to weigh up his own conflicting interests (e.g. between consumption now and consumption in his retirement). Grey areas between competition and optimisation arise when the options voted on are closely identified with the views of individuals or factions who vie for the support of uncommitted voters.

Reverting to the extent of authority, restrictions on the scope of what is competed for are less clear-cut in the case of the state. It is difficult to say what belongs within the realm of the government and what does not. Moreover, although the powers of individual organs of government may be restricted, on the principle of checks and balances, reservation of classes of issue for decision by a referendum of all voters are exceptional in democratic countries. This applies even to changes in the national equivalent of Articles of Association, namely a country's written constitution.[5] The potentially unlimited scope of political authority, conferred by most countries' constitutions and supported, in all countries, by the government's access to physical force, is one of the reasons why competition for it can be more crucial than CA in private organisations. How to prevent rulers from becoming tyrants has been designated the First Problem of Politics.[6]

CA can vary not only in its scope but also in its frequency. Authority can range from permanent, as in the case of a hereditary monarchy or a self-perpetuating Board of Directors, to only a few years, as with democratically elected governments. Correspondingly, the arbiters get a look in infrequently or frequently. Much the same is true of CT: it will be relatively infrequent in cases where contracts, or implicit contracts, are agreed that have substantial duration, as sometimes in the labour market and in relations with suppliers or distributors; at the other extreme CT may be virtually continuous, as in the foreign exchange market or on the stock exchange. During the tenure of the authority or the contract, competition is supended and to that extent made less severe overall, though participants may doubtless be influenced in their conduct by consideration of the next round (the 'reputation' factor). The duration of the time for which authority is conferred never approaches zero, unlike that of a transaction, because that would be inconsistent with the nature of authority itself. However, though there are never daily elections, there can exist continuous verbal opposition to the incumbent authority from an organised opposition party. This serves, up to a point, to prevent the suspension of competition from being absolute. It thereby intensifies competition in the regime generally. Such continuous verbal competition is a characteristic of politics but not, on the whole, of non-political bodies. It is true that chronic divisions and disputes do quite often occur within private organisations, sometimes on explicitly party-political lines and sometimes not, as in the Yorkshire Cricket Club and the RSPCA and of course in takeover contests. But the permanent existence of an opposition party in a private body is usually regarded as abnormal and a sign of something amiss. Why is this? Why does ICI not have a shadow Board to keep the actual Board on its toes? A large part of the explanation is surely that the organisation is thought of as a team, subject to CT with other organisations. Chronic opposition to the management from within would distract energies from the common task and be disloyal. The organisation may be thought to be less comparable to a government than to a family, with its need for mutual trust and support. In just the same way, in politics, even in democratic countries, opposition to the government is regarded as disloyal in times of war, when, exceptionally, competition with an outside opponent is the main business of the day (it is well-known that wars are attractive to dictators on this account). In the case of businesses, the lack of continuous CA, or even the lack of much CA at any time, matters less from the social point of view for the very reason that the firm is subject to the discipline of external CT. The existence of CT thus both makes CA less important and discourages it, at least unless CT becomes so severe as to threaten the survival of the organisation and makes a change in the management seem imperative. Conversely, the *absence* of CT in politics in peace-time creates the need for CA. The two forms of competition are thus to a large extent substitutes for each other, from both the positive and the normative points of view.

2. THE WORKING OF COMPETITION-FOR-AUTHORITY

How may CA be expected to work out? In particular, to what extent is CA an adequate substitute in the political arena for the CT that is not available there, for the twin purposes of avoiding inefficiency and exploitation?

Authority is a public good in the Samuelsonian sense. Whoever is successful in CA in a polity or organisation wields authority over all its

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