Does Power Sharing in Consensus Democracies Lead to Better Economic Outcomes?

In his attempt to refute the, “conventional wisdom” (Lijphart, 2012), that deliberation between majoritarian and consensus forms of democracy requires a trade-off between effective policy making on the one hand and accurate representation on the other, Lijphart purports to demonstrate that in the area of macroeconomic management consensus democracies are at least as effective as majoritarian democracies. His empirical data appears not only to confirm his hypothesis but to further suggest that in fact consensus democracies consistently achieve better macroeconomic outcomes especially in maintaining low levels of inflation and unemployment. By analysing Lijphart’s methodology and independent variables I will first refute the more extravagant claim of macroeconomic superiority before contesting Lijphart’s hypothesis itself on grounds of typological inconsistency and reliance on exogenous political culture. It is far from clear whether we should reject the conventional wisdom just yet.

While Lijphart’s regression results concerning GDP per capita growth, budget balance and economic freedom return the null hypothesis (that no difference is demonstrable between majoritarian and consensus democracies in these areas) the regressions involving inflation and unemployment suggest, on average at the 5% significance level, a negative correlation with consensus democracy. There are three methodological shortcomings I would like to highlight. Firstly, Lijphart assumes that a lower rate of inflation is unconditionally preferable to a higher one. While in general this is true, there is also considerable consensus that deflation can be damaging. Whilst the prolonged deflation in Japan reflects poor macroeconomic policy its low average rates in the periods tested help rather than hinder Lijphart’s case since Japan is a relatively consensual democracy. Furthermore, the utility of bank rates to control inflation is largely dependent on their ability to be lowered, thus many central banks set their inflation targets at 2%, avoiding lapses into deflation and ensuring manoeuvrability in light of an inflationary shock. In consideration of this I have re-calibrated Lijphart’s inflation data.
around the 2% level and taken absolute values to depict a country’s displacement from this level thus also removing the deceptive influence of deflation.

Secondly, Lijphart removes the extreme data points of Israel and Uruguay from the inflation regressions owing to their experiences of hyperinflation, he is of course right to consider the influence of outliers in such a small sample but is by no means thorough enough. At various points Iceland, Argentina, Jamaica and Costa Rica all experienced extreme levels of inflation\(^1\), indeed using the quartile method\(^2\) all four are revealed as technical outliers and should therefore be excluded.

Finally, and most importantly, Lijphart removes the 5 “ministates” with populations of less than 500,000 from all inflation, unemployment and GDP tests on the basis that their economies are so vulnerable to external shocks that their economic record is not fairly reflective of their government’s efficiency. Population is a poor measure of an economy’s vulnerability to external shocks, its influence is extremely indirect and dependent upon a multitude of other factors. A better proxy might be the market concentration of a country’s exports, for if a country has only one trading partner it’s economic performance is so dependent on it’s partner’s that we cannot hold its government fully accountable. I used WITS data to create an index of external economic vulnerability by taking the product of the HHI Market Concentration index and weighting it by a country’s trade as a percentage of GDP so that trade dependent countries with few partners would have a high score and insular countries with diffuse trading partners would have a low score (Figure 1). Once again using the quartile method I searched for outliers in this variable finding that only two of Lijphart’s five ministates, Luxembourg and Barbados, were particularly externally vulnerable. In addition, this analysis brought out Canada’s reliance on trade with the US which though stable detracts from the degree of responsibility we should attribute to the Canadian system for economic outcomes. Lijphart’s logic of removing countries that are dependent on external variables for their economic performance was sound, his means of exposing these countries was not.

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2 Data points that lie 1.5 interquartile ranges above the upper quartile or below the lower quartile.
Lijphart's Results

<table>
<thead>
<tr>
<th>Macroeconomic Performance Variable</th>
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<tbody>
<tr>
<td></td>
<td>Estimated Regression Coefficient</td>
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</tr>
<tr>
<td>CPI (1981-2009)</td>
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</table>

Figure 2 (Significance levels: ***[0.01], **[0.05], *[0.1])

Figure 3 (Significance levels: ***[0.01], **[0.05], *[0.1])
Having removed Barbados, Canada and Luxembourg from the analysis, restored the remainder of the ministates, re-calibrated the inflation variables and carefully excluded those countries that experienced extreme levels of inflation, the picture Lijphart’s data paints is much less clear (Figure 2). The significance of almost all of the linear models has decreased leaving only unemployment in the 1981-2009 period significant, albeit at the 10% rather than 5% level. Furthermore all the regression coefficients (excluding once more unemployment from 1981-2009) have reduced dramatically suggesting that the executives-parties dimension, which Lijphart uses exclusively to make his case, has very little bearing on the ability of a democratic system to keep inflation and unemployment low. Combining this with the null results derived from the areas of GDP per capita growth, economic freedom, budget balance and indeed all regressions concerning the federal-unitary dimension, it becomes clear that Lijphart’s tentativeness is wise; power sharing in consensus democracies does not lead to better economic outcomes.

Within the ten variables that Lijphart combines to form his executives-parties and federal-unitary dimensions of consensus-majoritarian democracy are two variables that have frequently and robustly been linked to better economic outcomes: corporatism and the independence of central banks. When business and labour are formally involved in the deliberative policy process, as in corporatist systems, both groups tend to seek representation from large inclusive organisations which better accommodates compromise over wage demands in return for employment guarantees thus securing both lower inflation and unemployment (Cameron, 1984). Pivotal to the influence of a central bank is its credibility. The greater the exclusion of partisan interests from monetary policy, the more credible the inflation target and the lower the public inflation expectations (Cukierman, 1992). If we remove the two variables that measure corporatism and the independence of central banks and rerun the regressions controlling for these factors we find that, while remaining relatively weak, all coefficients are reversed in direction (Figure 3). Anderson (2001) conducted similar empirical analysis on a sample of purely OECD countries and found likewise that the remaining four variables in the executives-parties dimension associated consensus democracies with higher levels of unemployment and inflation. His result was significant at the 5% level which can perhaps be explained by the fact that he controlled for ideology to account for the tendency of right wing governments to prioritise low inflation and left wing governments to prioritise unemployment (Hibbs, 1977). These results suggest that the performance of consensus democracies regarding economic outcomes is primarily driven by corporatism and central bank independence and perhaps that the majority of consensus characteristics are, in accordance with the conventional wisdom, detrimental to macroeconomic management. Therefore, in order to defend the hypothesis that consensus democracies perform at least as well as majoritarian democracies regarding economic outcomes, it is necessary to justify the position of both corporatism and independent central banks on the consensual side of Lijphart’s typology.
In attempting to explain why consensus democracies might produce better macroeconomic outcomes Crepaz (1996b) invokes Olson’s (1982) work concerning “encompassing organisations”. Olson suggests a link between the breadth of an organisation’s members and the proportion of society that benefits from its negotiation and activities. The large catch-all labour and business organisations that form under corporatism are clearly more encompassing than the multitude of niche unions and associations in a pluralist system. We might therefore rightly expect that the policies successfully advocated under a corporatist system would benefit a greater swathe of a country’s population than under pluralism, resulting in lower unemployment and inflation. Arguably however, coalition governments and a fractured party system, two products of PR and key characteristics of a consensus democracy, act in the opposite direction to Olson’s encompassing principle. In a majoritarian system parliamentary candidates have a strong incentive to align themselves with one of the main (usually two) parties which themselves have an incentive to address the concerns of a large section of society in order to secure a parliamentary majority. In a PR system candidates are able to gain office when standing for much smaller parties and can therefore address

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Figure 3 (Significance levels: ***(0.01), **(0.05), *(0.1))
particularistic interests. It seems that at least the manifesto policies of parties in a majoritarian system are more likely to benefit the whole of society than those policies held by parties in a PR system. Crepaz’s explanation relies on the assumption that PR parties are able to put the interests of the coalition above their own, the short lived nature of such coalitions suggests they generally do not (Anderson, 2001).

A better argument for why corporatism might sit well among consensus institutions might be given if you define the majoritarian-consensus spread in terms of the concentration and unification of power as Lijphart often does. To use the veto player analysis of Tsebelis (2002), by making labour and business representatives formal veto powers you are dividing and decentralising power. Proportional representation also increases the number of veto players by forcing political parties to form coalitions reliant on the continued support of most, if not all, of their members. It appears ironic however that consensus democracy would increase the number of veto players, reduce the size of the status quo winset and thus decrease the probability of a consensus actually being reached.

It might be tempting to depict an independent central bank as another veto player. However, by making the central bank independent of parliamentary influence you are, in effect, removing all existing partisan veto players from the monetary policy space and replacing them with a single veto player, the bank and its executives. This could explain why countries with independent central banks are more successful in controlling interest rates, since these banks are able to act quickly and decisively to stabilise inflation. If so, this is the exact advantage that was attributed to majoritarian political systems by Lijphart. In addition, the principle of accountability on which representational consensus government is reliant seems inversely related to the independence of a central bank. Central bank executives may be selected by directly elected politicians but it would be contrary to the benefits of having an independent central bank if they were accountable to these politicians or even to the broader public.

Theoretically it seems that independent central banks and corporatist interest group systems could be considered justified members of both consensus and majoritarian democratic forms. However, in Lijphart’s dataset and others, both ICB’s and corporatism are correlated with the other consensus variables. Without a sound structural explanation for this link we must look elsewhere for explanation. Lijphart himself suggests an underlying political culture and I am inclined to agree. The recent inability of researchers to replicate Lijphart’s clustering of consensus and majoritarian types in Eastern Europe (Fortin, 2008), Asia
(Croissant and Schachter, 2009) and Africa (Cranenburgh and Kopecky, 2004) suggests that the consensus-majoritarian typology may be reliant on a culture present only in OECD states, exogenous to Lijphart’s empirical analysis.

As a landmark case against dogmatic faith in the performance of majoritarian democracies Lijphart’s theoretical and empirical arguments are extremely valuable. However, as I have outlined above, the methodological rigour and remaining theoretical questions over the nature of independent central banks and corporatism leave us without conclusive evidence with which to make a judgement. In particular, the difficulties of measuring and controlling for political culture will have to be overcome if we are to establish which of consensus and majoritarian democracies produces the better economic outcomes.
References Used


Background Literature


• Anon, Available at: http://www.livingreviews.org/lrd-2010-3 [Accessed January 26, 2015].


R Script (resize as necessary)

#I have outlined below the code for the data presented in the essay. The variable label system
#will not make
#much sense in this limited context I am afraid, I used this to keep track of a much broader
#more experimental
#script.
#I have incorporated my own data into a modified version of \( L \), this is downloadable at
#https://drive.google.com/file/d/0B7yuP_CCxmnScnNvdEVFdEpDZFU/view?
usp=sharing
L=read.csv("ENTER FILE ROOT OF MODL")

#Code for the testing of outliers in index of external economic vulnerability.
L[L$exvulnerability_2009 > (quantile(L$exvulnerability_2009, c(0.75)) + 1.5*IQR(L
$exvulnerability_2009)), c("country", "exvulnerability_2009")]

boxplot(L$exvulnerability_2009, xlab="Index of External Economic Vulnerability",
horizontal=TRUE)
text(L[c(5, 8, 23, 4, 15),]$exvulnerability_2009, 1, labels=L[c(5, 8, 23, 4, 15),]$country , pos=3)
text(L[c(24),]$exvulnerability_2009, 1, labels=L[c(24),]$country , pos=1)

#Removing these outliers from further relevant analysis.
#Testing regressions with re-calibrated inflation, variables beginning with \( n \) have been
#recalibrated.

#E.g. \( \text{ncpi}_1981-2009 \).
#Each regression is preceded by outlier analysis code the results of which were interpreted and
#incorporated

#where appropriate.

B2=L[c(2:4, 6:7, 9:12, 14:21, 24:34, 36),]
+1.5*IQR(B2$ncpi_1981_2009)), c("country", "ncpi_1981_2009")]
-1.5*IQR(B2$ncpi_1981_2009)), c("country", "ncpi_1981_2009")]

B2o=L[c(2:4, 6:7, 10:12, 14, 16:17, 19, 21, 24:34, 36),]
$pop_in_thousands_2009))
summary(fcpilm1)

D2=L[c(1:4, 6:7, 9:22, 24:36),]
D2[D2$ncpi_1991_2009 > (quantile(D2$ncpi_1991_2009, c(0.75))
+1.5*IQR(D2$ncpi_1991_2009)), c("country", "ncpi_1991_2009")]
D2[D2$ncpi_1991_2009 < (quantile(D2$ncpi_1991_2009, c(0.25))
-1.5*IQR(D2$ncpi_1991_2009)), c("country", "ncpi_1991_2009")]

D2o=L[c(2:4, 6:7, 10:19, 21:22, 24:34, 36),]
plot(D2o$exec_parties_1981_2010,D2o$ncpi_1991_2009)
text(D2o$exec_parties_1981_2010,D2o$ncpi_1991_2009, labels=D2o$country)
fcpilm2=lm(D2o$ncpi_1991_2009 ~ D2o$exec_parties_1981_2010+D2o$hdi_2010+log(D2o
$pop_in_thousands_2009))
summary(fcpilm2)

E2=L[c(2:4, 6:7, 9:15, 16, 17, 19:21, 24:34, 36),]
E2[E2$ngdp_deflator_1981_2009 > (quantile(E2$ngdp_deflator_1981_2009, c(0.75))
+1.5*IQR(E2$ngdp_deflator_1981_2009)), c("country", "ngdp_deflator_1981_2009")]

summary(fcpilm2)
E2o=L[c(2:4, 6:7, 10:14, 16, 17, 19, 21, 24:34, 36),]
summary(fgdpdlm1)

G2=L[c(1:4, 6:7, 9:15, 16:22, 24:34, 36),]
G2[G2$ngdp_deflator_1991_2009 > (quantile(G2$ngdp_deflator_1991_2009, c(0.75))+1.5*IQR(G2$ngdp_deflator_1991_2009)), c("country", "ngdp_deflator_1991_2009")]
G2o=L[c(2:4, 6:7, 10:15, 16:19, 21:22, 24:34, 36),]
plot(G2o$exec_parties_1981_2010,G2o$ngdp_deflator_1991_2009)
text(G2o$exec_parties_1981_2010,G2o$ngdp_deflator_1991_2009, labels=G2o$country)
fgdpdlm2=lm(G2o$ngdp_deflator_1991_2009 ~ G2o$exec_parties_1981_2010+G2o$hdi_2010+log(G2o$pop_in_thousands_2009))
summary(fgdpdlm2)

I2=L[c(2:3, 6, 9:12, 14, 17:21, 27, 29:31, 33, 36),]
I2[I2$unemployment_1981_2009 > (quantile(I2$unemployment_1981_2009, c(0.75))+1.5*IQR(I2$unemployment_1981_2009)), c("country", "unemployment_1981_2009")]
I2o=L[c(2:3, 6, 9:12, 14, 17:21, 27, 29:31, 33, 36),]
summary(funemlm1)
summary(funemlm1)

J2=L[c(1:4, 6, 9:15, 17:22, 25:36),]
J2[J2$unemployment_1991_2009 > (quantile(J2$unemployment_1991_2009, c(0.75))+1.5*IQR(J2$unemployment_1991_2009)), c("country", "unemployment_1991_2009")]
J2[J2$unemployment_1991_2009 < (quantile(J2$unemployment_1991_2009, c(0.25))-1.5*IQR(J2$unemployment_1991_2009)), c("country", "unemployment_1991_2009")]
J2o=L[c(1:4, 6, 9:15, 17:22, 25:36),]
summary(funemlm2)

#For the following I have removed interest group pluralism from the executives-parties dimensions and rerun
#the regressions whilst controlling for interest group pluralism and the independence of central banks.
B2o=L[c(2:4, 6:7, 10:12, 14, 16:17, 19, 21, 24:34, 36),]
summary(efcpilm1)

D2o = L[c(2:4, 6:7, 10:19, 21:22, 24:34, 36),]
plot(D2o$std_exec_parties_1981_2010, D2o$ncpi_1991_2009)
text(D2o$std_exec_parties_1981_2010, D2o$ncpi_1991_2009, labels=D2o$country)

summary(efcpilm2)

E2o = L[c(2:4, 6:7, 10:14, 16, 17, 19, 21, 24:34, 36),]

summary(efgdpdlm1)

G2o = L[c(2:4, 6:7, 10:15, 16:19, 21:22, 24:34, 36),]
text(G2o$std_exec_parties_1981_2010, G2o$ngdp_deflator_1991_2009, labels=G2o$country)

summary(efgdpdlm2)

I2 = L[c(2:3, 6, 9:12, 14, 17:21, 27, 29:31, 33, 36),]
summary(funemlm1)

J2 = L[c(1:4, 6, 9:15, 17:22, 25:36),]
summary(funemlm2)