Monopolistic competition, auction and authorization: a Schumpeterian view of leadership and the political market

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Abstract: *»Monopolistische Konkurrenz, Auktion und Autorisierung. Eine Schumpetersche Analyse«*. The market analogy of democracy played a central role in one of the leading versions of democratic theory in the last fifty years, in the so-called “elite” or “competitive” theory of democracy. In the present paper, I first clarify that the dominant school of the market analogy (Downs and his followers) turned its back on the approach of the originator of the analogy, Joseph Schumpeter. Schumpeter argued that both economic and political competition – due to the activity of entrepreneurs – are necessarily monopolistic and destroy equilibrium. Second, I show how followers of the Schumpeterian market analogy improved upon it by using the concept of natural monopolies and making it conform to the characteristics of politics, while further distancing themselves from Downsian interpretation and the dominant Public Choice approach. Finally, I demonstrate a normative implication of monopolistic competition, namely its consequences for the concept of “agency loss”.

Keywords: democracy, market analogy, monopolistic competition, authorization, Schumpeter.

Introduction

The concept of democratic elitism appeared in the Post-Second World War period. It aimed at reconciling the elite perspective with democracy and became a dominant paradigm of democratic theory (Dahl 1956; Downs 1957; Sartori 1987; Schumpeter 1987). The reconciliation reflected the obvious fact that in modern democracies elected leaders and elites rule, but they are constrained in their rule and can be ousted by the voters. Rival elite teams compete for votes and power, and the electorates can choose who is authorized to govern. After the re-emergence of radical and participatory democratic theory in the 1960’s and 1970’s (Bachrach 1967; Pateman 1970), a new elite paradigm has been presented by John Higley and his collaborators (e.g., Field and Higley 1980; Higley and Burton 2006; Best and Higley 2010). The novelty of the new elite paradigm was threefold. First, unlike Schumpeter and other authors of

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democratic elitism, Higley and his collaborators formulated the social and political (elite) preconditions of stable liberal democratic regimes. Second, they revived the classical elitist tradition by switching their attention from political leaders to broader elite groups. In this new elite paradigm, three types of elite structures – ideological unity, disunity and consensual unity – are distinguished and treated as determinants of different regime types. Third, Higley and his colleagues widened their approach beyond the narrow focus of Schumpeter (1987), Downs (1957), and Dahl and Lindblom (1953). Unlike these authors, they pointed to an underlying ruling consensus (norms of competition) binding together elites "running" all democratic regimes. This elite consensus was regarded as a precondition of stable representative and liberal democracy. In this essay, which is a tribute to Higley's seminal work, I return to the "economic" approach reflected in the Schumpeterian version of democratic elitism. My aim is to demonstrate that, even if there is an underlying elite consensus, the nature of the competition ensures that democratic elitism is more "elitist" than it is often assumed.

The Novelty of Schumpeter's Approach

Joseph Schumpeter is widely considered the father of competitive theory of democracy that combines economic and political analyses and relies on the market analogy of democracy. However, later advocates of the economic-competitive theory of democracy (Downs 1957), as well as Public Choice theorists, took a sharp turn away from Schumpeter's approach, which was largely ignored by macro-economists, political scientists and democratic theorists.[1] Following the work of Anthony Downs, the dominant approach in these fields became one based on neoclassical economics and politics – against which Schumpeter had fought his whole life. Downs' theory is the political science equivalent of the neoclassical model of market economy. As David Miller pointed out in his classic article (1983), and as argued in more detail elsewhere (Pakulski and Körösényi 2012), Downs' model fundamentally differs from Schumpeter's approach. Schumpeter's theory of economic development and democracy is radically opposed to neoclassical economics and to the classical theory of democracy, as well as to Public Choice theory (from now on I will refer to the amalgam of the two as "the neoclassical approach").

The difference between Schumpeter's analysis and the neoclassical approach is stark. While in the neoclassical approach the (political) market is characterized by perfect competition, and as a consequence by market equilibrium – which also means reaching a social-welfare optimum – the work of Schumpeter aims at questioning the notions of balance and equilibrium. In his

[1] For an explanation of this neglect, see Best and Higley (2010, 4-5) and Higley (2010).

theory of economic development, Schumpeter refutes the analytic and normative theory of perfect competition. He shows that competition inevitably evolves into a monopolistic and/or oligopolistic form as a consequence of innovation and entrepreneurship – the major dynamic forces in both the economic and political realm. In Schumpeter's procedural-realistic theory of democracy, political leaders (entrepreneurs) play the role of innovators, similar to charismatic leaders in Weber's theoretical accounts. Moreover, Schumpeter warns readers against treating economic and political conduct as equal, and points to the limits of the market analogy. In political competition oligopolistic/monopolistic tendencies are much stronger than in the economy. The social usefulness of political innovation is often in doubt, and the manipulation of citizens' political preferences and demands is also more pronounced than in the case of the economic proceedings. This clearly indicates that the popular interpretation of Schumpeter's theory as a simple extension of economics and an exploration of the "market analogy" has to be treated with scepticism.

The aims in this paper[2] are, first, to show that Schumpeter's approach differs radically from that of "economic" followers of the market analogy, with whom his theory is often – but wrongly – conflated; and second, to show how followers of the Schumpeterian tradition improved on it by using the concepts of natural monopolies and monopolistic competition. These improvements also distanced Schumpeter's theory further from Downsian interpretations, on the one hand, and from the dominant Public Choice approach on the other. There is also a third, slightly less central aim: to highlight some analytic and normative implications of the Schumpeterian theory, especially his claims on the monopolistic nature of political competition. I will argue that the right use of the market analogy puts several aspects of democracy in a new light. From the Schumpeterian viewpoint, democracy can be approximated to a monopolistic competition, where the democratic electoral contest compares to franchise bidding for natural monopolies, and where the election winner is the highest bidder who gets authorization (a free mandate) to govern (cf. Pakulski and Körösényi 2012).

The argument is presented in five steps. In the first part, I comment on the originality of Schumpeter's approach as opposed to the dominant equilibrium theory, with particular emphasis on the median voter model, which is dominant in contemporary political science. In a second step, I analyze the monopolistic character of the political market, as portrayed by Schumpeter, and comment on the barriers to competition. In the third part, I supplement the analysis with Gordon Tullock's theory of the auction-type market of natural monopolies, which significantly improves the Schumpeterian approach. In a fourth step, I

2 An earlier version of this paper was presented at the ECPR General Conference, 24-27 August 2011, Reykjavik, Iceland. My research was supported by the Hungarian Scientific Research Fund (OTKA – T 049132).

analyse the effects of the monopolistic character of the political market and its impact on the functioning of democracy. Finally, I touch upon an important normative implication of monopolistic competition.

The Market Analogy of Democracy

Schumpeter's view of democracy parallels his theory of economic development, but there are clear differences between Schumpeter's theory of democratic competition and his later economic theory of democracy. These differences concern the equilibrium model, the theory of innovation and economic development, the role of the entrepreneur, and the status of monopolistic competition. While Downs clearly relies on an equilibrium model of democratic behaviour, Schumpeter rejects it. In his famous early work, The Theory of Economic Development (1959/1911) he set forth the idea, still relevant today, that qualitative change, or development, has a strong disequilibrating effect. In the static equilibrium model of neoclassical economics, change can only be interpreted as quantitative growth or decline, caused by external (exogenous) factors; therefore a state of equilibrium is incompatible with development. Schumpeter's view is that a state of equilibrium excludes the appearance of new kinds of products or goods, as well as new political viewpoints, problems or policy solutions. Such innovations disrupt the equilibrium, so that public good can no longer be identified with the state of equilibrium or with the political preferences of any "median voter".

This implies a specific view of development. In the neoclassical model of the market economy, and in the Downs' model of the median voter, there is no qualitative development, only quantitative change, caused by external factors. As Schumpeter explains, in the neoclassical model "economic life is essentially passive and merely adapts to the natural and social influences which may be acting on it" (1989, 159). Such quantitative change may be, for example, the rise in the price of a raw material, or an increase in the labour-supply in economics, and a change in voter preferences in politics. The equilibrium model shows how this effects a change in production, or in party (government) policy. By contrast, Schumpeter emphasizes the inner workings of development by qualitative change, by innovation, which implies the creation of something new, hitherto untried. Innovations, are defined by Schumpeter (1989, 138) as "changes in production functions which cannot be decomposed into infinitesimal steps. Add as many mail-coaches as you please, you will never get a railroad by doing so." "What we, unscientifically, call economic progress means essentially putting productive resources to uses hitherto untried in practice, and withdrawing them from the uses they have served so far. This is what we call 'innovation'," he explains (1989, 63-4).

The claim that brings Schumpeter close to democratic elitism is that entrepreneurs are agents of development and innovation (Best and Higley 2010, 3).

Entrepreneurial innovation, therefore, constitutes an endogenous explanation for development. The appearance of innovation, however, is neither natural, nor accidental: it is the result of conscious individual ambition and effort, which are the most important elements of entrepreneurial activity. Entrepreneurs, like Weber's charismatic leaders, are extraordinary people, who are not content with tried methods and past experience but create something new, or operate in a new way.[3] They do not merely react or respond to an outside demand; the demand and the impulse for change generated by the innovation are created by them (Schumpeter 1989, 27).

Why are entrepreneurs exceptional? Because "outside routine most people find it difficult and are often unable to act; those who can are rare and therefore not subject to competitive conditions, whence the phenomenon of profit" (Schumpeter 1989, 33).[4] An entrepreneur believes that "he is right, while everyone else is wrong" and sees an opportunity for profit in his superior perception (Loasby 1984, 79). Others can copy their behaviour later, after new things have been successfully done: and innovation spreads through industries by this copying. The same argument is applicable to the political market, although Schumpeter himself does not elaborate the details of this analogy in his *Capitalism, Socialism and Democracy* (1987).

Innovative behaviour and the function of entrepreneurs are distinct from routine behaviour and the mere "managerial" function that fits the equilibrium model. While traditional businessmen, managers and politicians react to existing demands for their standardized products, entrepreneurial activity "creates an expansion of demand for its own" – for its new products. The equilibrium model (both in economics and in political theory) narrows its focus to mere adaptation, which drives the process back to equilibrium. Equilibrium analysis, therefore, assumes adjustments to demands carried out by traditional businessmen or managers in the economy and by politicians in the electoral market. There is no room for the entrepreneur in such analysis.

The fourth element of Schumpeter's theory is the theory of monopolistic or oligopolistic competition. Both the neoclassical theory of economics and the median voter model of politics take perfect competition as a superior condition of the market. However, in Schumpeter's view, innovation and entrepreneurial

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3 "The function of entrepreneurs is to reform or revolutionize the pattern of production by exploiting an invention or more generally, an untried technological possibility for producing a new commodity or producing an old one in a new way, by opening up a new source of supply of materials or a new outlet for products, by reorganizing an industry and so on." (1987, 132).

4 "To act with confidence beyond the range of familiar beacons and to overcome the resistance requires aptitudes that are present in only a small fraction of the population and that define the entrepreneurial type as well as the entrepreneurial function. This function does not essentially consist in either inventing anything or otherwise creating the conditions which the enterprise exploits. It consists in getting things done." (1987, 132).

activity destroy perfect competition and create monopolistic positions in the market (1987, 132) and it is precisely perfect competition, a widely celebrated feature of the market in (neo) classical economics, that is incompatible with development understood as entrepreneur-driven innovation. His explanation is that free entry into the market and unrestrained competition would eliminate the profit of entrepreneurial activity and destroy the motive for innovation and progress.[5] Therefore, from the perspective of progress and development, "perfect competition is not only impossible, but inferior" (1987, 106). The emergence of oligopolies and cartels, as well as oligopolistic party systems, are not deficiencies of the market and politics, but inevitable consequences of competition and the innovative activity of entrepreneurs and political leaders.

From all this, we could assume that a Schumpeterian account of political innovation undermines perfect competition and the equilibrium model of politics. What is really Schumpeterian in this respect, however, is to acknowledge that leadership (innovation) and *perfect* competition are incompatible, and that the principle of "the more competition, the more efficient working of the market" is not valid beyond a certain point. True, entry barriers for outsiders and the lack of competition might mean a monopolistic position for a single political actor, and a long-lasting monopoly might have a negative impact on innovation and "progress," but too much, particularly unrestrained competition can also have a disastrous effect: it can destroy oligopolies, destabilize the political process and weaken the motivation of strong/large political actors (parties) for innovation. To sum up, the idea of perfect competition is undermined in a Schumpeterian account by the oligopolistic nature of leadership contest and party competition in democratic politics (Santoro 1993).

The Limits of the Market Analogy

The explanatory power of the market analogy has its limits. While Schumpeter introduces the market analogy to his analysis of politics, he also emphasizes some differences between the two. In short, there are stronger monopolistic elements in the political market than in the economic one. This point needs further elaboration.

First, the political market (electoral competition) is not an ongoing process. Unlike in the consumer market, there is no permanent feedback from citizens (political consumers); feedback works only at the distinct intervals of regular elections (cf. 1987, 263). Moreover, in the economy, producers' innovations are subject to "checks" and "falsifications" by consumers. People can buy and

[5] "But free entry into a new field may make it impossible to enter it at all. The introduction of new methods of production and new commodities is hardly conceivable with perfect – and perfectly prompt – competition from the start. And this means that the bulk of what we call economic progress is incompatible with it" Schumpeter asserts (1987, 104-5).

taste a new line of products, and having had this experience, they may abandon innovations and return to their regular brand. In politics, by contrast, citizens must vote for a candidate who promises a new policy without any chance to having an experience of its effects, and after electing her/him, they do not have the freedom to return to their earlier choice. Thus, in the political sphere, there is no direct opportunity for falsification, as Loasby notes (1984, 80).

Second, in politics the leaders set the agenda and manipulate the issues. "The ways in which issues and the popular will on any issue are being manufactured is exactly analogous to the ways of commercial advertising," argues Schumpeter (1987, 263). Moreover, advertising is more suitable for manipulation in politics than in the economy, since citizens, unlike consumers, do not have the possibility of changing their choice after a bad experience. The difference in the nature of private and political goods makes political advertising more efficient and strengthens the ability of politicians to manufacture the will of the people.

> The picture of the prettiest girl that ever lived will in the long run prove powerless to maintain the sales of a bad cigarette. There is no equally effective safeguard in the case of political decisions. Many decisions of fateful importance are of a nature that makes it impossible for the public to experiment with them at its leisure and at moderate cost,

suggests Schumpeter (1987, 263). In addition, citizens' political competence is weaker than consumers' competence. One of the sources of Schumpeter's top-down depiction of democratic politics, contained in his famous infantilism argument, is psychological.[6] Here the constraints lie in the differences between consumers' and voters' capacity for autonomous choice: there is more room for the manipulation of citizens' preferences than for the manipulation of consumers' choice.

Third, there is no real electoral control over public policy. This policy is formulated by politicians and governmental experts and then presented to the public, often with a heavy dose of persuasion. The function of elections is to produce (or evict) a government and citizens have only a limited and passive role in this process. The "acceptance of leadership is the true function of the electorate's vote" Schumpeter writes (1987, 273).

Fourth, elections mean, principally, the self-selection of leaders by obtaining public acceptance (votes). Schumpeterian democracy therefore means an open competition for leadership. Entrepreneurs of the market economy are not "elected" by consumers, they appear on the scene by their own efforts, supply-

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[6] Unlike in the "little field" of their everyday life, such as that of the consumers in the market, ordinary people are not capable of reasonable choice in the "wider field" of politics. However, what is the wider, political field for ordinary people is the narrower, little field for political leaders. Politics is the sphere of politicians' everyday activity, where they are familiar with the rules, conventions and other realities of life (1987, 258-61).

ing new products, etc. (self-selection). They have to "sell" their new products to consumers. This is similar in democratic politics where (elected) political leaders have to defeat their rivals first within the party in order to become the official electoral candidate. But Schumpeter is aware of the danger of negative selection in politics and warns of "the problem of the quality of the men the democratic method selects for positions of leadership" (1987, 288). He also emphasizes that governing needs different abilities to winning elections: "the democratic method creates professional politicians whom it turns into amateur administrators and 'statesmen'" (1987, 288).

Fifth, there is, a monopolistic tendency in every competition (Schumpeter 1987, 79), though the monopolistic features in politics are stronger than in the economy. We can say that in the circular flow of the economic process you can be, but you do not have to be, an entrepreneur. To be an entrepreneur is something special and rare. You can prosper by being a mere businessman or politician, by behaving in a routine way and according to your past experience and customs. In politics, however, there is a stronger pressure to innovate, to invent "new combinations", since the nature of rivalry is different. In politics incumbency is a natural monopoly, so that losers are strongly motivated to introduce an innovation in order to defeat the incumbent. Politics necessarily becomes a zero-sum game or a struggle for power (in the Weberian sense).

Sixth, even democratic government might be authoritarian. Schumpeter's procedural definition of democracy excludes many ways of securing leadership (e.g. military insurrection), but

> it does not exclude the cases that are strikingly analogous to the economic phenomena we label "unfair" or "fraudulent" competition or restraint of competition … (t)here is a continuous range of variation within which the democratic method of government shades off into the autocratic one by imperceptible steps (1987, 271).

This means that the electoral market is not only necessarily constrained and monopolistic, but that the deterioration of the quality of competition may transform the nature of government to be an even more autocratic one under the democratic method.

Tullock's Model of Democracy: Auction Market of Monopolistic Goods

As we have seen, Schumpeter also highlighted some differences between economic and political competition, and emphasized the limits of the market analogy of democracy. The dichotomy of the virtues and limits of the market analogy was also a focus of Gordon Tullock's work in the field of political economy. According to Tullock (1965), the competition among parties and/or candidates, and the democratic electoral process bears little resemblance to ongoing market processes. Rather he sees its structure as being very similar to auction markets of monopolistic goods; an insight that is used subsequently for the development of further arguments by Tullock, and later Demsetz (1968/1989). Tullock's basic idea has three major elements (cf. Wohlgemuth 2000, 277). First, we have to view government as a natural monopoly – in a democracy (nor any other kind of regime) there cannot be more than one government or legal system in existence at the same time. Neither can be more than one majority in the legislature on any given issue. Second, the license to operate this political monopoly can be won at periodically held auctions, that is, in a competition that serves as a barrier to the abuse of the right to govern. And third, the proper functioning of the auction market depends, among other things, on the threshold of entering the competition.

Tullock's analogy solves the paradox of the coexistence of elements of competition and monopoly. The winner of the competition wins the right to operate the monopoly for a predetermined length of time (the term of the license) – after that they have to compete again against other bidders for a renewal of the license. Tullock recognized that this model also gives a good description of the democratic competition for government power. The main characteristic of the structure of the political market being that, while there is competition for governmental power[7], for incumbents of governmental power[8] there is a monopoly instead of competition. Indeed, incumbency means the exclusion of all other competitors: there can be no competition in the act of governing and, as with natural monopolies, there are no rival political "producers". This is because, within a state, political consumers cannot choose among alternative public goods any more than city residents can choose among rival water companies that supply them with running water.

While at traditional auctions the highest bidder is the winner, in the auction market of monopolistic goods the winner will be either whoever pays the highest license fee for a monopoly, or whoever charges the lowest fee for a predetermined set of services or for performing a certain activity (e.g. supplying electricity for a city, or running a senior citizens' home). Tullock, then Demsetz, and other authors in the field of political economy and the new institutional economics, modelled democratic competition on the second analogy, whereby political entrepreneurs competing for government power are also bidding to run the government for a certain fee (e.g. at a certain level of taxation).

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[7] That is, "for the field" (Wohlgemuth 2000, 277-81).

[8] That is, "within the field" (ibid).

Contractual Disabilities

While Tullock's franchise-bidding analogy grasps the characteristics of political competition better than anything before, it is not unproblematic. Its difficulties stem from some fundamental differences between politics and the economy. Viewing incumbency as a natural monopoly and describing democratic competition as an auction market of monopolistic goods highlights many features of democratic politics that would otherwise remain hidden. However, Williamson (1976) and Goldberg (1976) point out that the license fee for incumbency cannot simply be determined by the auctioning of traditional market goods – and this gives rise to several problems. Williamson writes about the possibility of serious contractual disabilities among conditions of a lack of information and future risks, such as the uncertainty of award criteria, incomplete contract, and entry barriers. It is worth pausing for the moment to look at these problems in a way that Wohlgemuth (2000, 278-84) suggests, namely, by seeing the "auction process" as comprising three consecutive steps: first, the competition of the bids, second, setting the criteria for winner selection, and finally, looking at the nature of the contract with the winner.

1. Entry Barriers and Other Barriers to Competition

Schumpeter's theory of economic development suggests that perfect competition would cripple entrepreneurial efforts for innovation and development and hinder long-term investments. Therefore most entrepreneurs use different methods – such as patents – to defend against competitive pressures. In auction markets of economic monopolies, potential bidders are screened by strict rules (e.g. capitalization, length of history in the sector), and the same is also true in political markets. Indeed, one of the characteristics of the market for incumbency, as well as for any natural monopolies, is that they set strong barriers to competition. We have already seen that the operating of government stands as an intra-sector ("within the field") monopoly, so in this area there can be no competition at all. Whoever wins the license, gets an exclusive right for the term of the license agreement (in the case of the government this is usually four-to-five years, but in some sectors of the economy this is often decades) and becomes a monopolist (incumbent) in supplying the given public good, exempt from competition. The benefit is long-term stability, which means security for the long-term investments of the economic/political entrepreneur, but also stability for the consumer/citizen expectations. There is competition only beforehand, for the position of incumbent or for the license to operate a public good ("for the field"), so that competition only takes place periodically; even then it is limited.

The most important barriers are the difficulties of entering the competition, the so called entry barriers. The first such barrier is the length of the incumbency, that is, the periodical nature of elections, which makes competition possible only at the expiration of the license (mandate) to govern. A second barrier consists of various (legal or political) thresholds created by the electoral system, whereby entering the competition is not an automatic right and depends on the fulfilling of certain criteria. Electoral systems weigh votes differently (by applying mathematical formula) when awarding parliamentary seats. A third barrier involves strategic steps (e.g. policy or institutional reform) taken by incumbents to defend their political investments in certain policy areas from change beyond the term of the license. Such an amendment-barrier may be made possible by political tactics (party collusion) or by changing of the rules of the game (e.g. the constitution, the electoral system). Political investors can use these devices to defend their monopolistic position in place of the legal instruments, such as patents, that are available for economic entrepreneurs.

Wohlgemuth (2000, 291-92) emphasizes the trade-offs in politics between open competitiveness and the barriers to competition. On the one hand, barriers to competition play an important role in a democracy in that they enhance the stability of political expectations, and by this, they (a) enhance the incumbent's ability for long-term planning; (b) make it possible for the incumbent to carry the risk of reforms that are beneficial for the unorganized majority in the long-term, but are against the short-term interest of a small, but organized minority; and (c) increase the stability of the expectations of citizens and foreigners, which contributes to their willingness to invest in the economy in the long-term. On the other hand, open competition and contestability also have their advantages. First, they increase the motivation of the incumbent to adapt to changing citizens' preferences (responsivity); second, they increase the chances of getting rid of an incumbent unable to fulfil its past promises (accountability); and third, they provide incentives for political entrepreneurs outside government to enter political competition by exploring "new combinations" (innovation). Following Schumpeter's insights, we can say that perfect competition and pure monopoly are harmful in both the economy and in politics. However, there is no general, golden rule as to the desirable combination of the two.

2. Award Criteria

As opposed to auction markets of simple products and services, government deals with a political public good. Due to the intricacy and complexity of governing and to the existence of future contingencies, the winning bid cannot be selected by applying the principle of "the cheaper, the better". The ordinary franchise-bidding analogy also falters here because voters do not have a predetermined, unified and closed set of criteria by which to judge the bids. Furthermore, the bids themselves do not conform to any given pattern, so that they are often hardly comparable.

For democratic elections to function properly as auctions, voters would need to set up clearly defined "price-quality packages" embracing the complexity of government as evaluation criteria. This would only be possible if competitors were bidding only for a handful of public services predetermined by the voters. However – contrary to the presuppositions of the median voter model – there is no pre-defined political issue-space in elections.[9] Parties and/or candidates come forward with a complex package of propositions and with promises that are not limited to a predetermined range of political issues. It is precisely in the nature of Schumpeterian political entrepreneurs to come up with differing propositions, with new and innovative ways of solving problems, while shaping the evaluation criteria themselves and influencing or manipulating public opinion (see Körösényi 2010).

In Schumpeter's realistic world, voters do not set the agenda by defining what political services bidders have to offer, and they do not then select the "cheapest" bid. Rather, in this realistic world, political entrepreneurs set the agenda with their offers and voters can express their preferences only within this agenda, and within the accompanied – often quite vague – policy options (Wohlgemuth 2000, 278-79). As a consequence, in the world of monopolistic competition, the notion of "award criteria" loses its objective basis.[10]

3. Incomplete Contract

Election promises cannot be easily operationalized. Moreover, they are not legally binding. Thus, according to Williamson (1976 – cited by Wohlgemuth 2000, 278-279), in politics we can speak of contractual disabilities. One of these is the complexity of the incumbent function and the uncertainty of future conditions. In terms of the principal-agent model, the obligations of the agent cannot be fully specified in the contract, which inevitably leaves a lot of entrepreneurial freedom for the incumbent. Another contractual deficiency is that the contract between the principal and the agent is not only incomplete, or implicit, but practically non-existent. Elections are a special kind of auction where there is a one-sided authorization and no proper contract between the parties. As Schumpeter noted, at elections voters accept leadership and give their consent to be governed. Voters "decide" who will govern not by their own volition, but by their acceptance of leaders (1987, 270-3). The agents winning the incumbency have a relatively free hand (an unspecified mandate). Their freedom involves implementing political innovations that the principal had never thought of, and of which they would probably never have approved (Wohlgemuth 2000, 279). A further deficiency is that the agents' freedom is

[9] For more on the reasons of this, see the changing calculus model (Körösényi 2010), based on Riker's (1983; 1986) heresthetics, Budge and Farlie's (1983) salience theory and Stokes' (2001) mandate theory.

[10] Like reelection criteria, which – due to lack of information and future uncertainty – become undeterminable in accountability-theory (Manin et al. 1999), and lose their objective basis in the changing calculus model (Körösényi 2010).

further increased by not having their activity controlled by any kind of supervisor or license authority. The constitution, constitutional rules and conventions, which could be interpreted as controls, do not constitute a "final guardian" over incumbent political entrepreneurs, because the "self-regulatory" nature of politics makes it possible for the players to change the rules of the game (Wohlgemuth 2000, 279-80). As a consequence of these contractual disabilities, the notions of the principal-agent relation and contract can only be used as vague metaphors and can hardly be viewed as good analogies for describing the precise nature of the voter-incumbent relationship.

A Normative Implication: "agency loss"

The three limitations described above – barriers to competition, the evaporation of award criteria, and contractual disabilities – have serious normative consequences. One of them is that while the notion of "agency loss" can be applied in the median voter model (and can be viewed as a synonym for a breach of mandate), in monopolistic competition it can be used only in a limited sense. In a world that corresponds to the conditions of the median voter theory, market contracts are appropriately described by the principal-agent (P-A) model. Voters' interests are determined by the position of the median voter, which makes the mandate of the agent clearly defined, and the authorization of the agent constitutes a bounded mandate to perform a task according to the instructions of the principal. Accordingly, "agency loss" is clear and easily defined: it means the breaching of the contract and a violation of the principal's instructions by the agent. Examples of such violations include the agent taking advantage of the situation at the principal's expense, or failing to perform a task out of negligence.

In the model of Schumpeterian monopolistic competition, however, "agency loss" cannot be applied in its original sense, as set out earlier. Public interest is not a given, defined by contract. Rather, it involves establishing and proposing certain political objectives, and is a matter of constant interpretation and reinterpretation with its very definition being permanently contested by means of political innovation, including political advertising and manipulation. All this is bound up with the struggle for political support. The authorization of the winners of the incumbency-license, that is the political agents, is hard to define, and can hardly be made specific. Their authorization is thus broad, vague, unbound, and general, meaning that elected politicians get a relatively free mandate. The agent-politician becomes a trustee, rather than a delegate or deputy. The notion of "agency loss" evaporates, and can be applied only in a limited sense as "breach of trust," "misappropriation" or corruption.

Conclusions

The application of the market analogy in the median voter and Public Choice models has constrained political theory. Indeed, markets are misleading as analogies and should be used only as vague metaphors. They are certainly not appropriate as bases for comprehensive models of democracy. To grasp the nature of political competition, we have to turn to a special type of "markets", namely the auction markets of natural monopolies, as Tullock suggests. His specifications of Schumpeterian model of monopolistic competition, and its subsequent improvements by the new institutional economists, deliver several useful insights into the political process.

In a democracy, the competition for government can be described as monopolistic competition, which involves limitations and entry barriers. Contrary to widely held opinions in the literature, such barriers have several benefits: they make it possible for the incumbent to set aside short-term considerations of vote maximization, and execute long-term political investments (reforms) that outlast electoral cycles. At the same time, though, strong barriers to competition and a high threshold of entry can adversely affect selection of leaders and pose significant moral hazard. Moreover, the irrelevance of the meaning of "agency loss" indicates a decline of accountability – a serious potential problem in monopolistic competition. Thus, the auction-analogy affirms the Schumpeterian insight that competitive election of leaders does not mean giving a bounded mandate, as in the principal-agent model, but rather an acceptance of leaders (incumbents). Applying the principal-agent model to incumbency-licenses has also shown that license agreements are only vague metaphors. Political-electoral authorization means not delegation, but a free mandate for government.

Tullock's analysis of the auction markets and incumbency-licenses improves our understanding of the nature of monopolistic competition and confirms a sceptical reading of Schumpeter's theory of democracy. In themselves, elections do not constitute an effective method for holding rulers accountable, nor do they satisfy the requirements of Friedrich's rule of anticipated effects. They are, however, in line with Przeworski's (1999) minimalist notion of democracy, as well as with the authorization theory of representative democracy (Körösényi 2009). Open elections produce a broad authorization for governing, as well as making it possible to unseat incumbents who lose voter confidence. All this confirms Schumpeter's (1987, 271) suspicion that monopolistic competition, which is unavoidable in a democracy, in the end may blur the thin line between procedural democracy and authoritarian government.

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