Introduction

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This volume contains the papers presented at the international conference on 'Public Choice and the Problems of Democracy', organized by the Centre for Political Economy and Regulation, which took place in Madrid from 1–3 December 2005 at the University San Pablo CEU.

At this conference, some of the most prestigious public choice scholars presented their analyses of the main threats faced by democracy at the beginning of the twenty-first century and put forward some possible remedies, using the instruments and history of their lore. The 19 major chapters in this book cover issues ranging from general threats to a democratic way of life, to faulty institutional arrangements and defective voting rules that plague the political system, down to fiscal issues that affect the governability of democratic nations.

Public choice theory finds itself at present in a professional limbo. The *Journal of Economic Literature* subsumes it in microeconomics, or includes it in the theory of the firm, or notices it in regulation studies. The young see it as a mongrel of public choice theory and welfare economics and give it a wide berth. Others lump it with Austrian economics, implying an uncalled for disregard of both. It is too practical for today's model mongers or too humdrum for refined political philosophers. This is one reason why public choice scholars increasingly need to meet and publish the papers regularly presented at such venues as the annual meetings of the European Public Choice Society. This is what led us to convene this conference to see whether public choice scholars still had something useful to say about a real problem affecting us all: we chose democracy and its dangers.

We usually take it for granted that democracy is solidly established in the advanced developed countries and is here to stay. But history tells us that successful political regimes are not everlasting. True, never before in history have so many countries in the world (perhaps 86 out of the 192 independent countries in the world today) enjoyed a more or less stable democratic system. But even within old democracies, and indeed in the world at large, social, cultural and political divides have appeared that threaten democracy with strife and chaos.

Part I of this collection includes four chapters dealing with general problems of democracy. Chapter 1, 'Threats democracy faces: an overview', by one of the two editors of this book, José Casas Pardo, offers a general view of the problems of democracy in developed countries. He distinguishes between the endogenous and exogenous factors that are causing these problems. Among the endogenous factors is the generalized and deep uneasiness of citizens about the performance of political institutions. He argues that citizens ideally would want an improvement in the quality of performance, conduct and behaviour of politicians, an improvement that can only come about with drastic changes in institutions and behaviour. He also analyses the fact that voters have become unpredictable (so-called vote 'zapping'); that politics has become a self-regarding profession; that political parties, obeying Mosca's iron law, seem to have given up any pretence of internal democracy; that Friedrich von Hayek's remark that 'the worst come to the top' in centrally planned societies now seems more and more frequently applicable to democracies; that economic and social changes have blurred the dividing line between the old middle classes and the new working classes, leading to the 'rebellion of the masses' and the hectic and superficial lifestyles traduced by Ortega y Gasset in the 1930s; that voters are even less properly informed about issues than 'rational ignorance' would lead one to expect; and that the younger generations exemplify with a vengeance the lack of social values induced throughout society by the game of free riding on the welfare state. Among exogenous factors, Casas Pardo analyses the financial crisis of the welfare state and the refusal to reduce it in size; mass migration, multiculturalism and terrorism as a result of globalization, leading to a willingness of citizens to give up civil liberties in exchange for security and even to social conflicts and xenophobia; the short-term effects of globalization on labour markets and local firms; and relationships among individuals becoming ever more a zero-sum game.

In Chapter 2, 'Social justice examined: with a little help from Adam Smith', Anthony de Jasay, ever the unforgiving logician, shows that, despite its name, social justice is not a part of justice. The correct application of justice relies on previous rules. Social justice or taking from the rich to give to the poor can never be subject to rules since such redistribution must be unceasing and capable of continuously correcting its own consequences. However, *ad hoc* majorities will always be ready to coalesce with the aim of taking from the few to redistribute among themselves. Since these redistributive coalitions are of the essence of majority rule, de Jasay comes to the dismal conclusion that democracy as we know it will never be just and therefore never be stable. He then proceeds to examine whether democratic redistribution through forcible taxation can be justified in terms of a virtual social contract. He finds two widely canvassed solutions wanting: that of

an agreement to redistribute, made by the fearful rich behind a veil of uncertainty as to their future position, which, in his view, was proposed by James Buchanan and Gordon Tullock; and that of a compact reached behind a veil of ignorance by people wanting to have a minimum of 'primary goods' guaranteed, as put forward by John Rawls. He ends by examining neo-socialist justifications of 'social justice', based on the idea that what a person sells to others cannot be conceived to have been produced only by that person. But de Jasay counters by pointing out that all previous or concurrent producers have been paid for their contribution to the social product. Whether liberals in the American sense will be convinced is doubtful. The problems posed for our democracies by a proper understanding of justice seem to be insoluble.

In Chapter 3, 'Affective public choice', Frans van Winden argues that, due to the neglect of the role of the affective side of human nature in decision making, public choice scholars find it hard to explain some political and economic phenomena, for example: tax revolts such as the Boston Tea Party; casting votes that count for almost nothing at national elections; expensive and powerless monarchy in democratic countries; suicide bombings; and the preference for welfare entitlements compared to pure transfers. Taking into account the effects of emotions such as resentment, hatred, shame, fear and hope on action and choices will make those phenomena more understandable. Frans van Winden recalls that Adam Smith in the *Theory of Moral Sentiments* and indeed Benedict de Spinoza in his *Tractatus Politicus* present a more complete picture of humanity than some of the more orthodox economists of today. To these classics he adds evidence from laboratory games showing the importance of anger, shame and friendship to explain the evidence of what one might otherwise be tempted to dub irrational. Thus he recalls research suggesting that the eradication of poverty and illiteracy may not reduce the incidence of terrorism, since well-off educated youngsters may feel the emotions of resentment of oppression and involvement in a lost cause more keenly than needy and ignorant people. And he adds that it is not for nothing that Franklin Delano Roosevelt called welfare benefits and payroll taxes 'social insurance' and 'payroll contributions' – names that conjure up positive emotions and make it difficult to abolish them. One should not assume then that *homo sapiens* is purely *oeconomicus*. Emotions (such as enthusiasm, anger and fanaticism) must be taken into account when analysing behaviour in social and political contexts. His chapter is a useful addition to Jon Elster's 'Emotions in economy theory' (*Economic Journal*, March 1998) and he amusingly summarizes it by saying that 'those who cannot stand the heat should stay out of politics and public choice'.

In Chapter 4, Pedro Schwartz presents Jeremy Bentham as a very early forerunner of public choice. There was a deep inconsistency in his theory of utility, namely that individuals, though in fact driven by self-interest, have the obligation to work for the general good. But this inconsistency paradoxically helped him formulate the ‘agency problem’, a central topic in our field, and propose some remedies for ever-present power abuse. For Bentham, men and women were governed by two sovereign masters, pleasure and pain: their actions driven by an unceasing need to increase their personal happiness. However, enlightened self-interest should also lead them to work for the good of humanity, to be more precise, for the maximization of net social happiness summed over individuals. But even so, why should anyone not free ride on the cooperative behaviour of others? Hence the need for institutional arrangements to contain ‘sinister interests’ that Bentham explained in painstaking detail in the *Constitutional Code* (1830). The trouble is that he conceived the law as the changing expression of mere political will, and social life as an unremitting clash of opposed interests. As he did not understand the possibility of self-denying ordinances and overlooked the importance of mutually profitable exchanges, the mechanisms he proposed to harmonize individual aspirations had therefore to be all-embracing and infinitely particular. The resulting utilitarian commonwealth would be what Schwartz calls a ‘glasshouse democracy’, where nothing can be hidden from the penetrating vigilance of public opinion.

In Part II, six chapters deal with various institutional aspects of democracy. In Chapter 5, ‘Towards a more consistent design of parliamentary democracy and its consequences in the European Union’, Charles B. Blankart and Dennis C. Mueller argue that in most parliamentary democracies, parliament is elected to represent the opinions of the population, whereas the government is elected by parliament to carry out a particular political programme, which leads to inconsistencies. The combination of the two procedures often results in political outcomes deviating more from voters’ preferences than if only one of the two procedures is applied, since the preferences generated collectively in parliament often conflict with the programme pursued by the government. Unaccountable governments, voter alienation, strategic voting and governmental instability are shown to be consequences of this institutional mix. The authors propose reforms to produce two logically consistent alternative models of parliamentary democracy: either a pure form of representative democracy, where collective opinion is formed in parliament, or a pure two-party form of representative democracy where the government programme is chosen directly by the voters. Either system reduces the cost of the democratic process. This chapter is especially interesting when we examine the possible

application of one of these two forms of governance in the European Union, though the authors incline towards a pure form of representative democracy as the most suitable for Europe.

In Chapter 6, 'Democracy, citizen sovereignty and constitutional economics', Viktor J. Vanberg has undertaken a major exercise in conceptual clarification, as he himself explains. He explores the contributions that constitutional economics can make to the theory of democracy and how it supersedes welfare economics and the more invasive of the contractarian theories. Constitutional economics is the study of how the choice of rules affects social, economic and political interaction. As the applied science that it is, constitutional economics inquires into how people may realize mutual gains from joint commitments, or, in other words, how they can play 'better games' among themselves by exchanging commitments to common rules. Democratic polities are 'cooperative ventures for mutual advantage'; hence their citizens are the natural addressees for the kind of advice that such an applied science as constitutional economics may be able to provide. Vanberg draws a distinction between two different levels at which constitutional economics may provide advice to citizens: the first is that of operating rules; and the second is that of constitutional rules, that is, rules for choosing rules. The constitutional economist may proffer advice if he or she feels able to show that the changes proposed will allow citizens to reap mutual benefits. Such advice has two kinds of components, namely hypotheses about the factual working properties of rules on the one hand, and, on the other, assumptions about what, in terms of final outcomes, the citizen concerned will find preferable. The citizens are the ultimate judges. Vanberg concludes that the validity of such conjectures is to be judged in terms of empirical and theoretical arguments, not by second-guessing citizens' preferences under the assumption that they choose behind a veil of ignorance, as some contractarians are inclined to do.

In Chapter 7, 'Diffuse and popular interests versus concentrated interests: the fate of environmental policies in divided government', Giorgio Brosio refutes two connected ideas: that a Montesquieu arrangement of divided powers always favours the status quo; and that special interests always prove a match for more general interests prevalent in public opinion. Environmental policies could in principle be a case where concentrated interests should prevail over diffused interests. Brosio, however brings to bear numerous cases of countries where legislation for environmental protection is passed despite the contrary interests of industry, even where constitutional arrangements make change more difficult. Most of the countries he analyses (France, Germany, Italy, the Netherlands and the USA), where stringent environmental protection has been passed and is in fact applied, have bicameral non-congruent systems. The USA and Germany in

particular, which both have non-congruent and asymmetric federal systems, should fulfil the conditions in favour of the preservation of the status quo; and the veto power of the US president adds another feature to the divided governance, which could further delay environmental legislation. How, then, is one to explain changes in favour of environment protection and charging industrial groups accordingly? He conjectures that voters judge politicians, not on the basis of a detailed knowledge of their programmes but by a personal feeling as to how their past performance has affected their personal lives. Elections can be lost if voters have strong feelings of having been let down, which reduces the sway that special interests may have on legislators and governments. It seems clear that for some large issues people believe that important democratic decisions seep through the cracks of defective institutions.

In Chapter 8, Pascal Salin asks ‘Should the democratic model be applied to non-governmental organizations and firms?’ Democracy is the dogma of our time, as it is assumed that being democratic is good and not being democratic is bad, full stop. This has led to demands that a wide range of institutions be organized according to democratic rules. There are many institutions, both public and private (the army, the bureaucracy, churches, clubs, corporations, the family), to which democratic decision making cannot strictly be applied. However, the general feeling is otherwise. Why, people ask, should wage earners not participate in the strategic decisions of the firm? Should the family not be organized under the majority principle? Or perhaps the student body and the administrative staff of a university ought to take part in the selection of teaching staff. The pervasive demand for democratic solutions forgets that collective decision making is only to be resorted to when purely individual solutions cannot be used. Private property is not democratic; nor are human rights, to use the expression of the first liberal revolution in France: property excludes everyone but the owner and human rights permit us to resist the will of all other members of society. For large swathes of social life the application of democratic decisions is unacceptable. Instead of trying to extend the scope of democratic decisions, one ought to consider whether a better definition of property rights would not rather rid us of many collective decisions and, as a consequence, of democratic processes. Also democracy, whenever it exists, ought to be the result of free choices and not imposed by the state. That is, instead of wondering to what extent non-governmental organizations ought to imitate the decision-making processes taken from the political domain, one ought to consider to what extent the tasks actually performed by a democratic state could not be fulfilled by private contracts, and therefore according to non-democratic processes.

In Chapter 9, 'Citizenship and democracy in international organizations', Bruno S. Frey and Alois Stutzer start by quoting Robert A. Dahl, who categorically asserted that it is difficult if not impossible for citizens to exercise any effective control over most decisions on foreign affairs and that popular control over international organizations is practically impossible. Frey and Stutzer take the view that one should not only subject their undemocratic aspects to scrutiny and criticisms, but also make proposals for greater democratization. Today's international organizations perform an important and indispensable role in our world by carrying out allocative, redistributive and stabilizing functions, but they suffer from a lack of democratic legitimacy and participation. They take a leaf from the Athenian Constitution and later experiences, ranging from medieval city-states to the institution of the jury, and propose a novel idea for increasing the direct involvement of citizens in the governance of international organizations. A number of citizen trustees from each of the member countries of an organization, say 10,000 for the larger ones such as the United Nations, would be selected by lot at perhaps five-year intervals. They would have the power of initiative to propose policies and of recall to dismiss officials. Their decisions would be taken by mandatory referendum, on the basis of simple double majorities of trustees and countries. In sum, randomly selected trustees would have the final say. There is no doubt that choosing trustees by lot would result in a much fairer representation of people's preferences than parliamentary elections or winner-take-all presidential elections. The experience of Switzerland in semi-direct democracy, where citizen initiative and recall powers through referenda complements representation in parliament and indirect political participation via elections, should not be overlooked lightly. In any case, it is clear that many international organizations, not least the European Union, need to redress their democratic deficit.

In Chapter 10, 'Law and economic development: common law versus civil law', Francisco Cabrillo criticizes the generally accepted view that common law is a better framework than civil law for economies based on the principle of free exchange, and hence it is more conducive to growth. His evidence suggests that both civil law and common systems have followed a parallel evolution, leading to similar situations and adapting to the ideas and dominant values across societies in each historical period. To this end he compares the evolution of the major branches of private law, namely contract law and tort law, in Spain and the United States, one belonging to the civil law tradition and the other to common law. As regards contract law, he shows that, during the twentieth century, there has been a whittling down of freedom of contract in both systems: in Spain, through changes in the opinion of jurists and through law reforms; in the US, through

judicial sentences. Again, in the matter of tort, during the nineteenth century there was in both countries a bias in favour of industrialization: in Spain through pro-industrial administrative law; in the US, by judges moving away from the principle of strict liability to that of negligence. Then the twentieth century saw a marked increase in administrative regulation in civil law countries and in tort adjudication in favour of workers and consumers in US common law. The word *Zeitgeist*, Cabrillo argues, has influenced legal evolution to a larger extent than the differing structures of civil and common law legal systems.

In Part III, on voting issues, we include four chapters. In Chapter 11, 'A reformulation of voting theory', William A. Niskanen argues convincingly that our existing theory of voting behaviour (which is the core of public choice theory) is in total confusion because the theory of voter behaviour is asymmetric with the theory of candidate behaviour. The root of the problem is that the median voter theorem does not separate decisions *whether* to vote and decisions *for whom* to vote. In that model, voters are assumed to decide whether and for whom to vote at the same time, based on their understanding of the issue positions of alternative candidates. By contrast, the candidates are assumed to know the preference distribution of those who vote before they themselves choose and announce their issue positions. But the possibility that the party faithful may abstain changes the picture. Niskanen produces empirical evidence that incumbents courting the median vote in congressional elections are in greater danger of losing the vote of the faithful and therefore their seat. This leads him to conclude that American politics is becoming more polarized than can be predicted with the median voter theorem. He then comes to the rather dismal conclusion that 'Congress is becoming more like the Italian parliament – more partisan, a reduced ability to address major reforms, and an increased centralization of political power in the executive'.

In Chapter 12, 'Informational limits to public policy: ignorance and the jury theorem', Roger D. Congleton applies Condorcet's jury theorem to explain the success of democracies relative to other forms of governance since the industrial revolution. In its modern form, the jury theorem predicts that despite voters' rational ignorance, majority outcomes will be extremely accurate. Congleton uses simulations to explore the power and limitations of the jury theorem. The extent to which the mathematical results require very large electorates and independent datasets is not obvious in the jury theorem literature. The simulations that Congleton presents make some of the properties of the jury theorem less abstract and prove that many of the desirable properties of majority rule apply to relatively small electorates of poorly informed voters. This statistical property of democratic decision making has been well known among the broader

range of scholars who study political economy or public policy in general. On the other hand, it is evident that democratic politicians and politics are not always as good as the jury theorem implies they should be. If voter ignorance is deeper than usually assumed and some voters do not inform themselves at all about some relevant parameters, results may be biased.

In Chapter 13, ‘Democratic decision, stability of outcome and agent power, with special reference to the European Union’, Manfred J. Holler and Stefan Napel show that in order to understand policy making in a democratic setting characterized by voting, one has to take into consideration both the preferences of the decision makers *and* the procedural rules. Three prominent procedural rules are selected from the infinite set of alternatives – proposal-veto rule, gate-keeping and a simple sequential incumbent-opposition game – and analysed with respect to their implications for decision making, stability of outcome and discretionary power of the agent (that is, the policy maker). Analysis of the incumbent-opposition game shows that there is a chance for a rather stable policy arrangement, despite the fact that voter preferences are non-single peaked and incumbency may change over time, if the candidates are interested in both the policy outcomes *and* winning a majority in the ‘voting game’. The most fascinating part of the chapter is the application of its conclusions to decision making in the European Union. No doubt the Versailles Convention, which prepared the draft of the ill-fated European Constitution, could have usefully consulted with Holler and Napel.

In Chapter 14, ‘The unequal treatment of voters under a single transferable vote: implications for electoral welfare with an application to the 2003 Northern Ireland Assembly elections’, Vani K. Borooah analyses the 2003 Northern Ireland Assembly elections. Here again we have an illuminating application of public choice analysis to real situations. Borooah points out that the method of single transferable voting (STV) shows a disquieting feature, that has hardly been commented upon. This feature is that the second property of the STV (that it takes into account each voter’s range of preferences in determining the electoral outcome) does not work as it is meant to. Some voters have more than just their first preference taken into account, others only their first. This creates two categories of voters: favoured ‘further-preference’ voters and discriminated against ‘first-preference only’ voters. Applying these concepts to the STV-based 2003 Northern Ireland Assembly elections, this chapter shows that half of the voters were ‘further-preference’ voters. Also, the different parties had different endowments of voters from these groups. In particular, the Unionist parties had a disproportionately larger share of ‘further-preference’ voters compared to the Nationalist parties. According to Borooah, this could help explain why, even though the vote share of the

Democratic Unionist Party was only slightly higher, and the vote share of the Ulster Unionist Party was actually lower, than that of Sinn Féin, those two parties had disproportionately more seats in the Assembly than Sinn Féin. The chapter proceeds to argue that, if society is averse to inter-voter inequality, it might prefer a voting method that treated all voters equally rather than the STV method, even though the new method allowed a more limited expression of preferences for candidates.

Part IV, dealing with democracy across the world, includes two chapters. In Chapter 15, 'The pattern of democracy in the twentieth century: a study of the Polity index', Peter Sandholt Jensen and Martin Paldam apply the Polity index to measuring the evolution of the degree of democracy during the twentieth century for most countries. Starting with 52, the number of countries gradually increases to 160. The Polity index is a long-running project at the Center for International Development and Conflict Management, University of Maryland. Most economists usually rely on the Freedom House Gastil index and the chapter includes a useful appendix comparing both and explaining the authors' preference for the Polity index. Through their sophisticated statistical analysis, Jensen and Paldam measure the relative importance of the forces that make for democratization. They show that the effect of income on the political system is substantial, but that it takes some time for the full effect to seep through. Although it appears that democracy is path dependent and that therefore the Polity index contains strong inertia, economic growth at a certain point coincides with what they call the 'Grand Transition', when many parameters of society change together, giving increases of 30 to 40 times in income. Another result is the consistently negative sign to the Oil variable, especially clear if combined with the effect of Islam: it seems that a country getting rich on rents from natural resources does not democratize so readily and this observation is stronger when 'oil rich' means 'Muslim'. However, the authors note that, given the instability of the 'Muslim' coefficient, there is some hope that political divergence with the West may be transitory.

In Chapter 16, 'Democracy and low-income countries', Ayre L. Hillman explains why low-income countries, where economic development has failed, are in general autocracies rather than democracies. This goes contrary to the principle of encompassing interests, which predicts that autocratic rulers have personal incentives to seek economic efficiency and high economic growth, since they are residual claimants to take a share of national income or wealth for themselves. Consequently, it is necessary to identify why the personal interests of the autocratic rulers do not correspond to the encompassing interests of economic growth and efficiency. In his analysis, Hillman goes back to Nietzschean hierarchies, where the 'strong' in autocratic regimes exercise their will over the 'weak' without

ethical restraints, that the poor are held as hostages for foreign aid, and autocratic rulers fear that economic progress will create a middle class who will seek political participation through democracy. Consequently, Hillman has sought an explanation for regime change or transition from a Nietzschean hierarchy to the rule of law and an ethical society.

Part V, on fiscal issues and democracy, includes another two chapters. In Chapter 17, 'A theory of the democratic fiscal constitution', Francesco Forte and Domenico D'Amico start by pointing out that the four maxims on taxation laid down by Adam Smith in *The Wealth of Nations* in fact make up a fiscal constitution. They proceed to present an overview of the linkages between the neoclassical theory of fiscal economics, public choice and constitutional economics, and to outline constitutional fiscal rules based on the individual choice principle. They contrast this set of rules with the more generally accepted notion of a social welfare function in fiscal matters and what may be called the 'deceptive individualism' of social choice theory with its neglect of institution building. One of the defects of this latter view is that it focuses on *ordinary* political decision making, thus lacking the rudder of constitutional fiscal rules to guide the ship of state. Those basic rules should not be viewed as mere textbook benchmarks but as practical guidelines capable of application – rules of a fiscal constitution, both inside and outside the constitution itself.

In Chapter 18, '(When) do tax increases cause electoral damage? The case of local property taxes in Spain', Núria Bosch and Albert Solé-Ollé start by stating that it is often assumed that voters are aware of the money they pay in taxes, and that when they vote they make politicians accountable for tax increases. But the empirical analyses show only mild effects of taxation on voting. The authors set out to investigate two different answers to this contradictory phenomenon. One is that the voter decision is complex, and that voters take into account other issues when they go to the polls. The second answer is suggested by the fact that only governments who *raise* taxes suffer vote losses, and that those losses depend on the specific type and timing of the tax increases. To check these hypotheses they use an enormous database with nearly 3000 Spanish municipalities, and analyse three local election (1995, 1999 and 2003). In order to obtain unbiased estimates of the effects of taxes on voting, they control for other variables, such as national political shocks, ideological preferences of the citizens, the political hue of the government, and others. The results suggest that although non-tax issues to a large extent determine voting decisions, property tax increases have a non-negligible effect on the return of incumbents, especially when the government is a right-wing one, when it is a coalition and it is not in its first term, and when the tax increase is approved by the municipal legislative chamber and it is enacted in the second half of the mandate.

The final part contains the keynote address. The conference was honoured by the attendance of Gordon Tullock, one of the founders of public choice and an honorary doctor of San Pablo University. When addressing 'The mystery of Brazil', Tullock pointed out the geographical similarities of Brazil and the United States and the differences in exploitation of the hinterland and in general economic development. US citizens have a high standard of living, and their country is the major power in the world at this moment; Brazil on the other hand is still a developing country, albeit one of the important emerging countries. Tullock then started to look for possible explanations. He contrasted population size and demographic distribution, and differences in climate and food production. He also mentioned that in the United States, until recently, most of the immigrants were of European stock, while in Brazil immigration has been smaller and of more varied traditions. So the culture of the different population mixture has also played an important role. But on the whole, Tullock tended to think that the crucial differences lay in vastly different cultural and political traditions. He pointed out that the Portuguese and Spanish cultures are quite similar, and they both were different from the Anglo-Saxon one. English colonists had originally shown a tendency to engage in aggressive wars. US citizens (originally of British stock and mindful of the political system of their countries of origin) have shown much greater readiness to develop their natural resources, including those in the Mississippi basin, while Brazil has not yet fully developed theirs round the Amazon. Also the United States and Brazil have quite different legal and administrative systems. Finally, he underlined that the United States has enjoyed a democratic system from its birth, while Brazil is still handicapped by deficient popular representation and corruption.