

Norman Schofield · Gonzalo Caballero · Daniel Kselman *Editors*

## Advances in Political Economy

Institutions, Modelling and Empirical Analysis

This book presents latest research in the field of Political Economy, dealing with the integration of economics and politics and the way institutions affect social decisions. The focus is on innovative topics such as an institutional analysis based on case studies; the influence of activists on political decisions; new techniques for analyzing elections, involving game theory and empirical methods.

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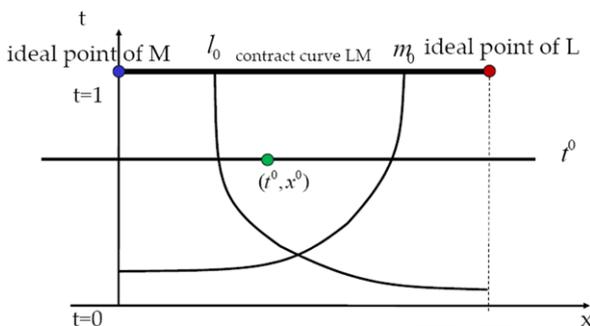
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599 **Fig. 2** A constitution which  
600 guarantees a positive  
601 monetary value to  $R$  does not  
602 exist when  $L$  is expected to  
603 negotiate with  $M$  over reform  
604 and  $w_M \leq \bar{w}$



### 611 3.2 $R$ and $M$ Negotiate on Constitutional Reform

614 In this section we assume that  $R$  and  $M$  are predicted to negotiate on constitu-  
615 tutional reform. This was effectively the bargaining set up in the Chilean transition  
616 with the PN of the right and the moderate concertación negotiating transition. The  
617 “Pinochet” constitution had banned left-wing parties from political participation and  
618 their admission was one element of constitutional reform which emerged from the  
619 negotiations. It is, therefore, possible to argue that the authors of the “Pinochet”  
620 constitution had believed that any successor government was not going to include  
621 parties of the left.

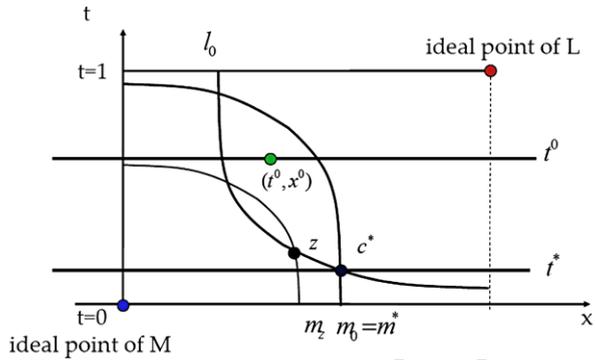
#### 624 3.2.1 Case $w_M > \bar{w}$

627 In this case there is harmony between  $M$  and  $R$  on their redistributive goals. Yet  $L$ 's  
628 participation constraint has to be satisfied. Without further constraints,  $M$  would  
629 choose her ideal point in  $I$  which is not the point with the lowest tax rate but a  
630 point on the contract curve with  $L$ . By strategically choosing the status quo con-  
631 stitution  $c^*$  to coincide with point in  $I$  where  $t$  is minimal,  $R$  can ensure a better  
632 outcome for himself: If  $M$  proposes against  $c^*$ , she has to offer  $t \leq t^*$  to  $R$ , so it  
633 must propose  $c^*$  itself. And if  $R$  proposes, he wants to propose  $c^*$  as well. Therefore,  
634 equilibrium  $c^*$  is a stationary constitution.

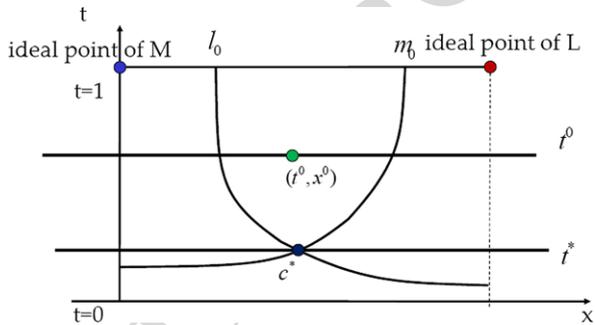
635 It is easy to see in Fig. 3 that a point such as  $z$  is not an optimal choice for a status  
636 quo constitution: When  $R$  proposes he needs to offer  $M$  the point  $z$  again because  
637 there the tax rate is lowest given that  $M$  must obtain  $m_z$  and  $L$  must obtain  $l^0$ .  
638 When  $M$  proposes, she needs to offer the point  $z$  as well. Thus,  $z$  is also a stationary  
639 constitution but it is not optimal for the autocrat.

640 Note that if  $L$ 's power to enforce outcomes in the conflict scenario is weak,  $I$  may  
641 include the  $t = 0$  axis. In that case,  $R$  and  $M$  will always agree on a tax rate of zero.  
642 The monetary value of writing a constitution is strictly positive, as the reversion  
643 outcome in the absence of a constitution involves  $t^0 > 0$ .

**Fig. 3** Optimal constitution when  $M$  is expected to negotiate with  $R$  over reform and  $w_M > \bar{w}$



**Fig. 4** Optimal constitution when  $M$  is expected to negotiate with  $R$  over reform and  $w_M \leq \bar{w}$



**3.2.2 Case  $w_M \leq \bar{w}$**

Finally consider the case where  $M$  has below average effective wealth and negotiates with  $R$ . In that case, it is straightforward that  $R$  selects the status quo constitution  $c^*$  by choosing the point in  $I$  where the tax rate gets minimal. This case is illustrated in Fig. 4. Again, it is easy to check that this constitution is stationary. Moreover, the constitution has monetary value to the autocrat because  $I$  is not vanishing by Lemma 2 and, hence,  $t^* < t^0$ .

**3.3 Other Cases**

For the case of negotiations between  $R$  and  $L$ , the choice of a constitution follows the same pattern as in the case of negotiations between  $R$  and  $M$ : If the middle class has more than average effective wealth,  $c^*$  is chosen in the point in  $I$  where the tax rate gets minimal (see Fig. 3). If  $M$  has less than effective average wealth,  $c^*$  is again chosen in the point in  $I$  where the tax rate gets minimal (see Fig. 4).

The same holds if a proposal in the constitutional bargaining game needs approval of all three players. In that case, any selection of  $c \in I$  leaves no proposer

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with another possibility than proposing  $c$ . Hence, the autocrat selects his preferred point in  $I$ , as in the case where  $R$  and  $M$  negotiate with each other.

To complete our exposition, suppose that one party is sufficient to carry through constitutional reform. Majority rule may put one party in such a position even when the other parties can prevent her from realizing her ideal point in the conflict scenario. If the preexistence of a constitution  $c$  is necessary to prevent descent into conflict, such a constitution would at least be weakly acceptable as a template to all players and it would be strictly preferred by the player who stands to gain from the reform process. Moreover, if the dominant party selects a reform constitution within the constitutional process, it will propose its preferred point in  $I$ . The question for the autocrat of whether to write a constitution now reduces to whether the dominant party will select  $t < t^0$  in the constitutional process. This is obviously the case when either  $M$  is predicted to be dominant and fulfills  $w_M < \bar{w}$  or when  $R$  is dominant. Hence, in those cases writing a constitution creates positive monetary value for the autocrat. On the other hand, if  $L$  is predicted to be dominant, it offers  $M$  and  $R$  their reversion value which puts them in no better place than with open conflict. Hence, incentives for writing a constitution would completely vanish. The same applies to the case where  $M$  with  $w_M > \bar{w}$  is dominant. The following proposition summarizes our results:

**Proposition 7** *With negotiations between  $M$  and  $R$  or between  $L$  and  $R$  or with all three players, writing a constitution always has positive monetary value for the autocrat. If there is one dominant party in the constitutional reform process, writing a constitution only has positive monetary value for the autocrat in the cases where  $R$  is dominant or an  $M$  party opposed to redistribution is dominant. If  $L$  or an  $M$  party in favor of redistribution is predicted to be dominant, the autocrat is indifferent between writing and not writing a constitution.*

## 4 A Model of Intertemporal Constitutional Choice

The previous section has introduced a static model of constitutional choice where the autocrat can choose the default constitution for his successors without incurring any cost such as being bound by the constitution himself. In practice, it is likely to be a condition for a constitution to be acceptable that it actually has been adhered to for some time before the regime's demise. In addition, the autocrat may not know the precise date of his demise and, therefore, will want to write and implement the constitution at a time when the probability that he will be in his post for another day is still greater than zero. On the other hand, the consequences of successfully handing down a constitution might be felt for a long time. Therefore, we think it is reasonable to assume that the autocrat will attach non zero weights to the cost which he incurs by not realizing his preferred policy outcome  $(0, x^R)$  during the time for which he has to abide by the constitution himself and to the gains his constituency realizes during the time when his successors deliver a preferred policy outcome.

We assume, that depending on the expected length of time in both states and the discount rate of the autocrat, these weights assume the values  $(1 - \delta)$  and  $\delta$ . Even though  $(1 - \delta)$ , which increases with the time in office, may itself depend on the choice of the autocrat's constitution, we ignore the possibility of such endogeneity. If the autocrat hands down a constitution, he choose the constitution  $(t, x)$  which gives him the highest total benefit, i.e. he maximizes

$$V_R(t, x) = (1 - \delta)u_R(t, x) + \delta u_R(\Gamma(t, x)).$$

If he does not hand down a constitution, his total pay off is

$$V_R(\emptyset) = (1 - \delta)u^R(0, x_R) + \delta u_R^0.$$

By selecting a constitution  $c' \notin I$  which is not binding during his term in office, the autocrat can realize the same pay off as with no constitution in the initial period and a pay off  $u_R(\Gamma(c')) \geq u_R^0$  in the second period. The latter relationship follows because the successors want to choose a reform constitution  $(t, x) \in I$ .<sup>23</sup>

In all cases, where the monetary value from writing a constitution in the static model is strictly positive, there must exist a constitution which the autocrat strictly prefers writing if the weight of the future is sufficiently great:

**Proposition 8** *If the weight of the future,  $\delta$ , in the autocrat's objective function is sufficiently great, there is a binding constitution which the autocrat strictly prefers to hand down in all cases where there is a positive monetary value to writing the constitution in the static model.*

*Proof* The autocrat can always choose to hand down the statically optimal constitution. For that constitution, the cost of commitment  $u_R(x^*, t^*) - u_R(0, x_R)$  is finite and the benefit of commitment is strictly positive, i.e.  $u_R(x^*, t^*) - u_R(\Gamma(c' \notin I)) > 0$  if, as we have claimed, there is a positive monetary value to writing the constitution.  $\square$

In all cases where there is no positive monetary value to writing a constitution the autocrat would only consider writing a constitution which is non binding during his term of office. This scenario comprises the cases where  $w_M \leq \bar{w}$  and  $L$  is dominant or bargains with  $M$  bargain and the case where  $L$  or an  $M$  party in favor of redistribution is dominant in the succeeding assembly.

Finally, even when choosing a binding constitution, the autocrat may not necessarily want to choose the stationary, statically optimal constitution. At least in those case where the statically optimal constitution does not involve choosing the point in  $I$  where  $t$  gets minimal, i.e. in the case where  $L$  is expected to negotiate with an  $M$  party opposed to redistribution, the autocrat faces a trade off between loosening the constraint during his term in office and creating stronger incentives for a low tax regime after his demise:

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<sup>23</sup>See the proof of Lemma 3.

**Proposition 9** *In the case where  $L$  negotiates with  $M$  and  $w_M > \bar{w}$  there exists a critical weight  $\delta^*$  such that if  $\delta$  falls below that weight, the autocrat compromises on the statically optimal constitution.*

*Proof* Let  $p^M$  be the probability that  $M$  proposes in the bargaining process. If the autocrat chooses the statically optimal constitution  $c^*$ ,  $M$  proposes  $c^*$  and  $L$  proposes  $c^*$ . Now suppose that the autocrat chooses a constitution with a slightly smaller tax rate such as  $z$  in Fig. 1. In that case,  $M$  continues to propose  $c^*$ , so the autocrat gets  $t^*$  with a weight of  $p^M\delta$ . If  $L$  proposes, she proposes  $t'(t', x')$  in the intersection of  $m_z$  and the contract curve.  $t' > t^*$ , hence the outcome is worse for  $R$  and it is weighted with  $(1 - p^M)\delta$ . However,  $t^z < t^*$ , hence by choosing  $z$ , the autocrat realizes a better outcome with a weight  $(1 - \delta)$ . Hence, for  $\delta \rightarrow 0$ ,  $c^*$  results in a higher value of  $V_R$  and for  $\delta \rightarrow 1$ ,  $z$  results in a higher value of  $V_R$ .  $\square$

Obviously, for very small  $\delta$ , the autocrat may not want to hand down a constitution. Therefore, the critical weight  $\delta^*$  only becomes relevant if the distance between  $t^0$  and the statically optimal constitution  $c^*$  is sufficiently large to induce the autocrat to write a constitution given  $\delta^*$ . The following proposition generalizes this insight on the desirability of writing a constitution:

**Proposition 10** *The greater the power of  $R$  in the transition scenario and, hence, the smaller  $t^0$ , the less value writing a constitution has.*

*Proof* In all cases where there is a monetary value of writing the constitution, the dynamically optimal constitutional choice  $c$  is independent of  $t^0$ . Hence,  $R$ 's benefit of writing a constitution,  $u_R(\Gamma(c)) - u_R(t^0)$  is increasing in  $t^0$ , i.e. the smaller  $t^0$ , the smaller the benefit. Finally,  $u_R(\Gamma(c)) \leq u_R(t^0)$ , hence the benefit must vanish as  $t^0 \rightarrow 0$ .  $\square$

## 5 Application to Different Experiences of Political Transition

From our analysis two hypotheses emerge.

1. If an autocrat expects that his own clientele will have influence on a succeeding constitutional assembly, he generally has incentives to write a constitution, although those incentives vanish if he expects that parties opposing redistribution will be able to impose their preferred policy without the left being able to object.
2. If an autocrat expects that his own clientele will have no influence on a succeeding constitutional assembly, he only has strong incentives to write a constitution if he expects that the middle class prefers a low redistribution policy.

In the case of the Chilean constitutional project, it seems plausible that the conditions for constitution writing in hypothesis 1—negotiations between the right and the middle class under a sufficiently strong perceived threat by the left—have been

829 met or were believed to be met by the autocrat. That the left would not in a formal  
830 sense be involved in negotiations over a successor constitution was plausible from  
831 the point of view of the old regime because it did its utmost to keep it outside the  
832 political process. As it turned out, a substantial part of the left also objected to ac-  
833 cept the constitution as a vehicle towards political reform.<sup>24</sup> If one accepts that one  
834 rationale of the Pinochet regime for embarking on the constitutional project was  
835 to build a bulwark against communism, as suggested by Montes and Vial (2005),  
836 the possibility of a left-wing threat must have been on the mind of the authors of  
837 the constitution. Protest movements such as the one led by copper miners in 1983  
838 (see Collier and Sater 1996) and the so-called “protesta” movement which involved  
839 members of privileged, middle and working class (see O’Donnell and Schmitter  
840 1986) must have reminded the junta of such a lingering threat.

841 An interesting question which remains is which the influence of middle class  
842 wealth has been in the case of Chile’s successful constitutional transition. The mod-  
843 eration which the parties of the concertación showed in the transition process sug-  
844 gests that redistribution was not on the mind of the middle class which it represented.  
845 In an accompanying paper we discuss the relationship between middle class wealth  
846 and stable transition in the Chilean case in greater depth (Michalak and Pech 2012).

847 It is more difficult to see to which case the Egyptian transition corresponds. The  
848 Muslim brotherhood, with its social welfare goals probably best fits the descrip-  
849 tion of leftist in the context of our model. On the other hand, the often secular  
850 groups which started the street protests voiced aspirations which are more compati-  
851 ble with a middle-class mind set with an emphasis on improvement of opportunities  
852 rather than the redistribution of existing wealth. Moreover, Egypt’s Gini coefficient  
853 is lower than Chile’s and the wooing of the presidential candidate of the right for  
854 the voters of this “middle class” further supports the view that Egypt best fits the  
855 case of a country with a middle class opposed to redistribution. This would give  
856 the autocrat strong incentives to write a constitution provided that he expects that  
857 the constitutional reform process takes the form of multiparty bargaining. If, on the  
858 other hand, the expectation is that the Muslim brotherhood plays a dominant role in  
859 the constitutional reform process, there is no value at all to writing a constitution.

860 Therefore, the prediction of our model critically depends on the prior about the  
861 bargaining strength of the different players in negotiating constitutional reform. In  
862 the case where the Muslim brotherhood is expected to be dominant, we predict that  
863 no constitution will be handed down. In the case where multiparty bargaining is  
864 expected to take place, we predict a constitution will be handed down which might  
865 be significantly amended in the bargaining process. Moreover, there are reasons why  
866 the monetary value of constitution writing may be low even when the expectation is  
867 multiparty bargaining: The autocrat may predict the military to be a strong player  
868 with significant power to enforce a high default outcome in any transition process  
869 or he may predict a long time horizon of his rule. In these cases he would have been  
870 reluctant to chose a constitution which binds his own actions. Finally, it is unclear  
871

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872  
873 <sup>24</sup>For a dissenting view see Tapia (1987).  
874

875 how to interpret the fact that the constitution was formally revoked even by those  
876 players who would have stood to benefit to the extent that they expected to have a  
877 share in future bargaining over reform. An orthodox interpretation of this fact would  
878 be to say that non compliant constitutional practice during the autocracy turned out  
879 to be a bar to acceptability. However, our model suggests a second interpretation  
880 which is more in line with the observation that the property order established under  
881 the constitution was kept in place. This observation would correspond to the case of  
882 stable constitutional transition but with major amendments.

883 We lack observations where constitutional succession was tried in the face of a  
884 middle class supporting redistribution. On the other hand, our model predicts that  
885 such cases would be rare to observe. What our model highlights, though, is the im-  
886 portance of established property rights as an element of constitutional arrangements  
887 which the autocrat wants to protect. This may shed a light on the failure of stable  
888 constitutional transition in the case of former communist countries. This was not  
889 completely for the lack of trying because at least in the case of Poland we observe  
890 a transition through pact between the old and incoming power (see Munck and Leff  
891 1997). However, in the case where a new constitution has to legitimize an emerging  
892 property order, the stakes are quite different from the cases discussed in this paper.  
893 Indeed, it will be more important for emerging property owners—often members  
894 of the former nomenclature—to secure their share in the emerging property rights  
895 before they can think about securing those property rights within a constitutional  
896 compact.

## 897 898 899 **6 Further Discussion** 900

901  
902 The main lesson which emerges from the model and the preceding discussion is  
903 that handing down a constitutional compact offers benefits to the autocrat's clien-  
904 tele in almost all cases where multiparty bargaining is expected during the transi-  
905 tion process: If a constitution is accepted by its successors, it provides insurance  
906 against being excluded from transition bargaining as long as the middle class is  
907 opposed to redistribution and improves the bargaining position of the clientele re-  
908 lative to representatives of other classes. There is no such benefit if during transi-  
909 tion one party is able to impose its preferred outcome. This suggests that there are  
910 economic and political conditions which facilitate successful constitutional transi-  
911 tion. If the middle class is sufficiently wealthy to oppose redistribution, it serves  
912 as a natural proxy for the autocrat's clientele during the transition process. Fur-  
913 thermore, only if society is sufficiently heterogeneous such that there are different  
914 groups with diverging interests which find it necessary to reach compromise in the  
915 transition process is there a role to play for any inherited constitutional template.  
916 The latter point suggests that transitions such as in Poland or in South Africa where  
917 Solidarnocz and the ANC emerged as main players were less open to be manipu-  
918 lated by autocratic constitutional choice than the transitions discussed in this pa-  
919 per.

920

## Appendix

In this appendix we show that in the case where  $L$  and  $M$  bargain and  $w_M > \bar{w}$  the contract curve is vertical for  $0 < t < 1$ . For convenience, we define the income gap of each group relative to average available income as  $\Delta_M = w_M - \bar{w} \leq 0$ ,  $\Delta_L = w_L - \bar{w} < 0$  and  $\Delta_R = (1 - \gamma)w_R - w > 0$ .

For  $0 < t < 1$ ,  $M$ 's proposal  $P^{M \rightarrow L} = (t', x')$  given  $c = (t^*, x^*)$  solves the constrained optimization problem

$$\max [v_M(x) + (1 - t)w_M + t\bar{w}] \quad \text{s.t.} \quad v_L(x) + (1 - t)w_L - t\bar{w} \geq u(t^*, x^*).$$

Writing  $\mu(x') = \frac{\frac{\partial v_M(x')}{\partial x}}{\frac{\partial v_L(x')}{\partial x}} \leq 0$ , the first order conditions for an interior solution of this problem,  $x'$  satisfies

$$\mu(x') = \frac{\Delta_M}{\Delta_L} \tag{3}$$

and the tax rate is determined as the residual satisfying

$$t' = \frac{v_L(x^*) - v_L(x')}{(-1)\Delta_L} + t^*. \tag{4}$$

At  $x^M$ ,  $\mu(x^{M \rightarrow L}) = 0$  and at  $x^L$ ,  $\mu(x^{M \rightarrow L}) \rightarrow -\infty$ . By continuity of  $\mu$ , a solution  $x'$  satisfying the first order conditions uniquely exists with  $x' \in [x^M, x^L]$ . As  $\frac{\partial v_M(x')}{\partial x} = -2|x' - x_M|$  and  $\frac{\partial v_L(x')}{\partial x} = 2|x' - x_L|$ ,  $x'$  only depends on the ratio  $\frac{\Delta_M}{\Delta_L}$ . By construction,  $x'$  is the policy level which is Pareto-optimal for  $L$  and  $M$ . Call this policy realization  $x^e$ . It is easy to show that  $L$ , when proposing to  $M$  selects the same policy  $x^e$ .

The optimal proposal can be interpreted as follows:  $x^e$  is the policy which would maximize the joint pay off for  $L$  and  $M$  given that transfers between  $M$  and  $L$  can only be achieved through the linear tax system:  $\frac{\Delta_M}{\Delta_L}$  is the rate at which  $M$ 's income is converted into  $L$ 's income as the tax rate increases. Note that a transfer rate of greater than  $-1$  signifies an involuntary contribution of  $R$ .<sup>25</sup> If the ratio is  $-1/2$ , it costs half a unit of  $M$ 's income to increase  $L$ 's income by one unit.  $\mu$  is the rate at which  $M$ 's utility from consuming  $x$  increases per unit of utility decrease by  $L$ . In an optimum,  $M$ 's gain has to be equal to  $M$ 's cost of compensating  $L$  at an admissible tax rate  $t \in (0, 1)$ .<sup>26</sup>

<sup>25</sup>One can show that the ratio is greater than  $-1$  if  $\frac{w^L + w^M}{2} < (w^M - w^L)$ , i.e. if  $M$ 's wealth exceeds  $L$ 's wealth by more than average wealth, where the latter is calculated looking at  $M$  and  $L$  only. To demonstrate this point, note that  $\frac{\Delta_M}{\Delta_L}$  can be written as  $\frac{w^M + (w^M - w^L) - w^R}{w^L - (w^M - w^L) - w^R}$ .

<sup>26</sup>If  $\Delta^M / \Delta^L = -1$ , we obtain the familiar policy choice rule of selecting  $x$  half way between the bliss points, see e.g. Baron and Diermeier (2001).

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