

Introduction

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This volume contains the papers presented at the International Conference on “Public Choice and the Challenges Democracy Faces” that took place in Madrid from December 1st to December 3rd, 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 21st century and put forward some possible remedies, using the instruments and history of their lore. The nineteen major papers 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 young shun it. The JEL 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. Book catalogues, such as those of Edward Elgar, the publisher this book, 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 disregard is a reason why Public Choice scholars increasingly need to meet and add volumes to the collections of papers regularly presented as such venues as the Annual Meetings of the European Public Choice Society. This is what led us to convene this Conference and see if Public Choice scholars still had something useful to say about a real problem affecting us all: we chose democracy and its dangers.

We are used to taking 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 do so many countries in the world (perhaps 86 out of the 192 independent countries in the world today) enjoy a more or less stable democratic system. But even within old democracies, and indeed in the world at large, social, cultural, political divides have appeared that threaten democracy with strife and chaos.

Part I of this collection includes four papers dealing with **general problems of democracy**. The first paper, titled “Threats Democracy Faces: An overview”, written 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 endogenous and exogenous factors causing these problems. Among the endogenous factors, he mentions 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 in the 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 (vote ‘zapping’ so called); 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 Hayek’s remark that ‘the worst come to the top’ in centrally planned societies” now seems more and more frequently 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 life styles traduced by Ortega y Gasset in the 1930’ies; that voters are even less properly informed about issues than ‘rational

ignorance' would lead one to expect; 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 terrorism; the financial crisis of the Welfare State and the refusal to reduce it in size; mass migration and multiculturalism as a result of globalisation, leading to a willingness of citizens to give up civil liberties in exchange for security and even to social conflicts an xenophobia; the short term effects of globalisation on labour markets and local firms; and relationships among individuals becoming ever more a zero sum game.

In his paper "Social Justice Examined", 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 to take from the few to redistribute among themselves. Since these redistributive coalitions are of the essence of majority rule, Jasay comes to the dismal conclusion that democracy as we know will never be just and therefore never be stable. Jasay 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, agreed to by the fearful rich behind a veil of uncertainty as to their future position, as in his view Buchanan and Tullock proposed; 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 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 him or her. But Jasay counters by pointing out that all previous or concurrent producers have been paid for, 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 "The Affect Component of Democracy", Frans van Vinden 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, such as 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 bombing, and the different attachment to pure transfers compared with welfare entitlements. 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 Vinden recalls that Adam Smith in the *Theory of Moral Sentiments* and indeed 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 call up positive emotions and make it difficult to abolish them. We should not assume then that *homo sapiens* is purely *oeconomicus*. Emotions (such as enthusiasm, anger, fanaticism) must be taken into account when

analysing behaviour in social and political contexts. His paper is a useful addition to Jon Elster's "Emotions in Economy Theory" (*EJ*, March 1998) and he amusingly summarises it by saying that 'he who cannot stand the heat of emotions should stay out of politics and Public Choice'.

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 of working for the general good. But this inconsistency paradoxically helped him to formulate the 'agency problem', a central topic in our field, and to 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 maximisation 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 those 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 harmonise 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 eye of public opinion.

In **Part II**, six papers deal with various **institutional aspects of democracy**.

In their paper "Towards a More Consistent Design of Parliamentary Democracy and its Consequences in the European Union", Charles B. Blankart and Dennis 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 program, 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, as often the preferences generated collectively in Parliament conflict with the program 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 program is chosen directly by the voters. Either system reduces the cost of the democratic process. This paper is especially interesting when examining the possible application of one of these two forms of governance in the European Union, though the authors incline for a pure form of representative democracy as the most suitable for Europe.

Viktor Vanberg has written a major paper titled "Democracy, Citizen Sovereignty and Constitutional Economics", an 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 the people may realise mutual gains from

joint commitments, or, to put it differently, 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 level is that of operating rules; and the second level is that of constitutional rules, i.e., 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 conjectures have 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 contractarian are wont to do.

Giorgio Brosio, in “Diffuse and Popular Interests versus Concentrated Interests: The fate of the environmental problems in divided government systems”, tries to refute two connected ideas: that a Montesquieu arrangement of divided powers does not always work in favour of the status quo; and that special interests do not 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. Professor Brosio however brings to bear numerous cases of countries where legislation for environmental protection is passed over the interests of industry to the contrary, 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. Especially the USA and Germany, which both have non-congruent and asymmetric federal system, should fulfil the conditions in favour of the preservation of the status quo; and the veto power of the president of the USA adds another feature to the divided governance, which could further delay environmental legislature. How is one then to explain changes in favour of environment protection and the laying of costs on industrial groups? 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 affected their personal lives. Elections can be lost if voters have strong feelings of having been let down, which reduces the sway special interests may have on legislators and governments. It seems clear that for some large issues citizens deem important democratic decision seeps through the cracks of defective institutions.

“Should the Democratic Model Be Applied to Non-Governmental Organisations and Firms?”, asks Prof. Pascal Salin. Democracy is the taboo of our time, as it is assumed that being democratic is good and not being democratic is bad. This has led to demands that a wide range of institutions should be organised 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. The general feeling is other. Why, people ask, should wage-earners not participate in the strategic decisions of the firm? Should the family not be organised 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 the fact that collective decision making is only to be resorted to when purely individual solutions cannot be used. Private property is not

democratic; neither are the rights of man and citizen, to use the expression of the first and liberal revolution in France: property excludes everyone else and human rights permit me to resist the will of all the others. 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 wonder whether a better definition of property rights could not allow to get rid of many collective decisions and, as a consequences, 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 wonder to which extent of the tasks actually performed by a democratic state could not be fulfilled by private contracts, and therefore according to non-democratic processes.

Bruno S. Frey and Alois Stutzer are the authors of the chapter on “Citizenship and Democracy in International Organizations”. They start by quoting Robert A. Dahl who categorically asserts that it is difficult if not impossible for citizen 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 we should not only subject their undemocratic aspects to scrutiny and criticisms, but also make proposals for greater democratisation. 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 from mediaeval city-states to the institution of the jury to propose a novel idea for increasing the direct involvement of citizens in the governance of international organisations. A number of citizen trustees from each of the member countries of an organisation, say 10,000 for the larger ones such as the UN, 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 the preferences of the citizens 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 completes representation in Parliament and indirect political participation via elections, should not be overlooked slightly. In any case, it is clear that many international organisations, not least the European Union need their democratic deficit redressed.

In his paper “Law and Economic Development: Is common law better than civil law?”, Francisco Cabrillo criticises the generally accepted view that common law is a better framework for economies based on the principle of free exchange than civil law is and hence it is more conducive to growth. His evidence suggests that both civil law and common systems have followed a parallel evolution, reaching similar objectives and adapting themselves 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 20th 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, there was during the 19th c. in both countries a shift in favour of industrialisation: 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 20th c. saw a marked increase in administrative regulation in civil law countries and in tort adjudication in favour of workers and consumers in common law United States. The World *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** of this volume on **voting issues**, we include four papers. The first one is “A Reformulation of Voting Theory” by William Niskanen. The author 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 lies in that the median voter theorem does not separate decisions *whether* to vote and decisions *for whom* to vote. In that model voters are assumed whether to vote and for whom to vote at one go and based on their understanding of the issue positions of alternative candidates. By contrast, the candidates whereas 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 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 their seat. This leads him to conclude American politics is becoming more polarised 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, with a reduced ability to address major reforms, and an increased centralization of political power in the executive”.

In his interesting paper “Informational Limits to Democratic Public Policy: the Jury Theorem and Rational Ignorance”, Roger Congleton applies the Condorcet’s jury theorem to explain the success of democracies relative to other form of governance since the late industrial revolution. In its modern form, the jury theorem predicts that despite voter 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 data sets is not obvious in the jury theorem literature. The simulations Congleton presents in this paper make some of the property of the jury theorem less abstract and prove that many of the desirable properties of majority rule apply to relatively small electorates of slightly informed voters. This statistical property of democratic decision making has been well known among the broader range of scholar 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 their paper “Democratic Procedure, Stability of Outcome and Agent Power, with special reference to the European Union” Manfred Holler and Stephen Napel show that in order to understand policy making in a democratic setting characterized by voting we have to take into consideration 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 (i.e., the policymaker). 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* the winning of a majority in the “voting game”. The most fascinating part of the paper is the application of its conclusions to decision making in European Union. No doubt the Versailles Convention that prepared the draft of the ill-fated European Constitution could have usefully consulted with Holler and Napel.

Vani K. Borooah is the author of the paper “The Unequal Treatment of Voters”, where the analysis is applied to 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, which has hardly been commented upon. This feature is that the second property of the STV (that it takes account of each voter’s range of preferences in determining the electoral outcome) does not work as announced. 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 “first preference” only voters. Applying these concepts to the STV based 2003 Northern Ireland Assembly Elections, this paper shows that one 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 paper proceeds to argue that, if society is averse to inter-voter inequality, it might prefer a voting method which treated all voters equally rather than the STV method, even though the new method allowed a more limited expression of preferences over candidates.

In **Part IV** dealing with **democracy across the World**, we include two papers. The first is by Arye Hillman, “Democracy and Low-Income Countries”. It tries to explain 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 seek the reasons why the personal interests of the autocratic rulers do not correspond to an 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, the poor are held as hostages for foreign aid, and that autocratic rulers’ fears that economic progress will create a middle class that will seek political participation through democracy. All this granted, Hillman he ought to find an explanation of regime change or transition from a Nietzschean hierarchy to the rule of law and an ethical society.

“The Pattern of Democracy in the 20th Century: a study of the Polity Index” by Peter Sandholt Jensen and Martin Paldam applies the said Index to measuring the evolution of the degree of democracy along the 20th century for most countries, starting with 52 countries and seeing the number increase gradually 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 another index, the Gastil index from the Freedom House and there is a useful appendix comparing both and explaining the authors’ preference for Polity. Through their sophisticated statistical

analysis, they try measure the relative importance of the forces that make for democratisation. They show that the effect of income on the political system is substantial, but that it takes some time for the full effect to set through. Though 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 democratise so readily and this observation is stronger when 'oil rich' means 'Muslim'. The authors however note that, given the instability of the 'Muslim' coefficient, there is some hope that political divergence with the West may be transitory.

Part V, on fiscal issues in democracy we include another two papers. One, by Francesco Forte and Domenico d'Amico, titled "A theory of the Democratic Fiscal Constitution", starts 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 neoclassic 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 it self.

In their paper "When Do Tax Increases Cause Electoral Damage? The case of local property taxes in Spain", Nuria Bosh and Albert Solle-Olle 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 a complex phenomenon, and that voters take into account other issues when they go to the polls. The second answer is suggested by the fact that only government experience electoral 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 data base 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, though non-tax issues to a large extent determine voting decisions, property tax increases have a non negligible effects on the return of incumbents, especially when the government is a right wring one, when it is a coalition and it is not in its first term, and when the tax increase is approved by the municipality legislative chamber and it is enacted in the second half of the mandate.

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 USA 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 developing country, albeit it is one of the important emerging countries at this moment. He 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 USA, up to 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 wide apart cultural and political traditions. He pointed out that the Portuguese and the Spanish cultures are quite alike, and they both were different from the Anglo-Saxon one. English colonists had originally shown a tendency to engage in aggressive wars. The citizens of the USA (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 have not yet fully developed theirs round the Amazon. Also the US and Brazil have quite different legal and administrative systems. He finally underlined that the USA has enjoyed a democratic system from its birth, while Brazil is still handicapped by deficient popular representation and corruption.