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POWER SHARING AND REFORM CAPACITY

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ABSTRACT

In this paper I argue that reform capacity, defined as the extent to which political institutions facilitate the adoption of socially efficient reforms, is not primarily determined by the number of veto players in the political system, but by the availability of institutional mechanisms that allow political agents to solve commitment problems associated with bargaining over reform. Specifically, I argue that power sharing is compatible with high reform capacity if policy areas involved in package deals are all controlled by the central government (or whatever level of government makes the reform), and if the 'losers' are confident that they will remain veto players in the future.

KEY WORDS • institutions • reform • veto players

1. The Problem of Reform Capacity

The reform capacity of democratic governments is an old problem in comparative politics. Generations of political scientists have characterized certain political systems as deadlocked, or stalemated, or otherwise incapable of reforming themselves (in the 1990s, for instance, students of German politics frequently commented on that country's alleged *Reformstau*). Yet social scientists have only recently begun to abstract from case-specific observations and empirical generalizations, developing more systematic analyses of reform capacity.

Many scholars believe that reform capacity is higher in political systems where political power is concentrated in a small number of institutions, parties, and organizations than in systems where power is shared. The most influential theory of policy change in contemporary political science, George Tsebelis's theory of veto players, supports this old idea. Tsebelis's theory suggests that 'policy stability', defined as the 'impossibility of significant change of the status quo', is increasing in the number of partisan and institutional veto players, and in the ideological distances between them (Tsebelis, 2002). Policy stability, Tsebelis argues, 'will make the change of even an undesirable status quo difficult' (Tsebelis, 2000: 443).

In this paper I argue that if reform capacity is defined as the extent to which political institutions facilitate the adoption of socially efficient reforms (reforms that increase social welfare), and if we make the reasonable assumption that political agents are at least in principle able to make side payments in order to compensate veto players that would otherwise oppose reform, then the theory of veto players does not offer any clear predictions about the relationship between power sharing and reform capacity. According to the analytical models presented in this paper, power sharing does *not* reduce reform capacity, as long as political institutions allow political agents to solve certain commitment problems associated with political bargaining. Specifically, power sharing is compatible with high reform capacity if the policies that are used to make side payments are controlled by the veto players that share power and if the 'losers' are confident that they will remain veto players in the future.

Although this is primarily a theoretical paper, it has an empirical motivation: the theory of veto players does not perform well in empirical studies of reform capacity. Section 2 reviews empirical evidence on pension reforms in Europe in the 1990s and 2000s, demonstrating that in this policy area, which is particularly relevant to the problem of reform capacity since there is broad agreement that pre-reform pension systems in Europe were unsustainable, significant reforms have occurred both in countries with few veto players and in countries with many veto players. Section 3 defines reform capacity, discusses the relationship between this paper and related work in political science and economics, and explains how side payments can be used to facilitate reforms. Section 4 presents three simple formal models of the politics of reform, generating predictions about the influence of institutions and party politics on reform capacity. Section 5 concludes with some reflections on possible extensions of the argument.

2. Pension Reforms in Europe

Ever since the 1980s, the reform of existing welfare programs has been one of the most salient issues in European politics. The need for reform (that is, the inefficiency of status quo policies) has often been politically contested. However, in one area, old-age pensions, there has been broad agreement among economists and politicians that pre-reform welfare programs were fiscally and socially unsustainable – primarily, but not exclusively, because of population aging (for a useful overview of reform pressures and reform options in pension politics, see Schludi, 2005). This makes pension policy an important test case, allowing us to examine whether the theory of veto players can explain the ability of governments to change unsustainable or otherwise inefficient policies.

In one of the first major studies of European pension reforms, Giuliano Bonoli observed that significant reforms have been possible both in systems with many veto players and in systems with few veto players, noting that even 'governments enjoying low levels of power concentration' have been 'able to achieve some change' (Bonoli, 2000: 172). According to Bonoli, *processes* of reform have varied depending on political institutions, but not the overall reform intensity. Specifically, since 'radical and unilateral reforms' are 'not "politically feasible"' in countries in which constitutional arrangements encourage power-sharing', governments in such countries 'combine retrenchment with quid pro quos' (Bonoli, 2000: 173). In other words, countries with many veto players tend to adopt negotiated reforms that take the form of broader policy packages.

This observation is echoed in Martin Schludi's study of reforms in 'Bismarckian' pension systems, published five years later, which claims that almost all pension reforms in Bismarckian countries depend either on a deal between the government and the parliamentary opposition or a deal between the government and the trade unions. Schludi concludes that although reforms have been blocked by veto players in some multi-actor systems, such as Austria, 'even weak governments confronting powerful and reform-resistant trade unions [which are organizations with *de facto* veto power] can use their agenda-setting powers to obtain union consent to cuts in pension spending if they offer them attractive compensation payments' (Schludi, 2005: 241). Again, the evidence does not support the hypothesis that power sharing decreases reform capacity, suggesting instead that political agents in systems with many veto players use side payments to achieve desired reforms.

The broadest overview of pension reforms to date, the *Oxford Handbook of West European Pension Politics* (Immergut et al., 2007), also demonstrates that the veto player model fails to account for the intensity of pension reform in European welfare states, which is especially noteworthy since one of the editors wrote an early contribution to the literature on veto players and 'veto points' (Immergut, 1992):

> We began this comparative study with the assumption that governments in countries with greater numbers of veto players or effective veto points would be impeded in their efforts to introduce significant pension reforms. But this is not what we have found. Instead, we were puzzled that some countries with few veto players and no veto points – such as the UK, Greece, and France – pulled back from controversial pension reforms when they encountered voter resistance. At the other extreme, countries with many veto players and effective veto points – such as Finland and Switzerland – adopted significant legislation. (Immergut and Anderson, 2007: 24)

The editors of the *Handbook* argue that the veto player model must be complemented with a theory of party competition. A specific version of this argument is also one of the main conclusions of this paper, for one of the results of my theoretical analysis is that the behaviour of veto players is influenced by whether they expect to remain veto players in the future (which might also account for the Finnish and Swiss anomolies that Immergut and Anderson mention, since both countries have a history of oversized coalitions).

The most recent major study of pension politics in continental Europe – Silja Häusermann's study of France, Germany, and Switzerland (Häusermann, 2010) – argues that a high number of *de jure* veto players (such as political parties) and a high number of *de facto* veto players (such as interest organizations) can actually be a political *asset* for reform-oriented governments. In a multi-dimensional policy space, Häusermann argues, political fragmentation allows for 'coalitional engineering', increasing the likelihood of 'modernizing' reforms.

This review of research on European pension reforms suggests the following general observations.

1. There is little evidence that countries with few veto players have undertaken more significant reforms than countries with many veto players.

2. Reforms in countries with many veto players tend to take the form of package deals that include side payments.

3. Reform capacity varies among countries with many veto players.

The remainder of this paper develops a theoretical argument that accounts for these observations, showing that power sharing is compatible with high reform capacity (point 1), but only if governments are able to solve the commitment problems involved in bargaining over reform (point 3). Furthermore, the argument will show that the distributional consequences of reforms vary across countries since reforms in multi-actor systems require side payments (point 2).

3. Two Paths to Reform

3.1 Defining Reform Capacity

As noted in the introductory section, this paper defines reform capacity as the extent to which political institutions facilitate the adoption of socially efficient reforms (reforms that increase some measures of aggregate welfare). This means that reform capacity is not synonymous with what Tsebelis calls 'low policy stability'. My definition is more closely related to definitions used in economics, where the term 'reform' is often taken to mean 'the adoption of a superior policy' (Drazen, 2000: 405).

Consider a more formal definition of reform capacity. Following Acemoglu (2003), let aggregate income, Y (as a proxy for social welfare), be a function of X and P, so that

$$Y = F(X, P),$$

where X is a vector of economic and social conditions that cannot be altered by the government and P is a vector of policies that can be altered by the government. In order to make the argument more general, Y can be interpreted as a welfare index that includes several types of goods (such as a list of what John Rawls (1971: 92) calls 'primary goods'), but the assumption is that all actors have identical preferences over these goods. Now, still following Acemoglu (2003), define $\mathbb{P}(\cdot|X)$ as the set of policies that maximize Y, given the conditions X. Note that $\mathbb{P}(\cdot|X)$ may have more than one element. In fact, as Acemoglu points out, most students of comparative political economy believe that there is more than one efficient institutional equilibrium in contemporary capitalism (cf. Hall and Soskice, 2001).

Denote status quo policies by P_s. If $P_s \notin \mathbb{P}(\cdot|X)$, status quo policies are inefficient, since there is a non-empty set of potential reforms that, if implemented, would increase Y. A socially efficient reform can be defined as a policy change that replaces P_s with new policies, which we can denote by P_r ('r' for reform), where $F(X, P_r) > F(X, P_s)$. Reform capacity can then be defined as the extent to which political institutions facilitate the adoption of reforms that are efficient in this sense. Under perfect reform capacity (an unattainable ideal, of course), the policy regime is always an element in $\mathbb{P}(\cdot|X)$: whenever conditions change, policies adapt instantaneously, retaining optimal welfare.

The problem of reform capacity has both static and dynamic dimensions. In a static perspective, reform capacity is an important political and intellectual problem since some countries appear to become stuck in inefficient equilibria (students of the welfare state, such as Rhodes (1997), sometimes characterize Southern European welfare states in this manner). In a dynamic perspective, reform capacity is an important problem since if the efficiency of government policies is a function of social and economic conditions, then when conditions change, policies must follow. Economic conditions change, as a result of innovations, interdependence, and structural shifts in the labor market (Castanheira et al., 2006; Sapir, 2006). Social norms and practices change, rendering the behavioural assumptions that informed past policies invalid (Lindbeck et al., 1999). Finally, changes within the political system itself – such as the introduction of new management techniques, administrative procedures, and policy instruments – sometimes enable efficiency-increasing reforms.

3.2 Veto Players, Side Payments, and Reform Capacity

The theory of veto players, which has been introduced and developed by George Tsebelis in a series of papers and books from the 1990s and 2000s, is a natural starting point for a discussion of reform capacity. The theory of veto players predicts that 'policy stability (defined as the impossibility of significant change of the status quo) will be the result of large coalition governments, particularly if the coalition partners have significant ideological differences among them' (Tsebelis, 1999: 591). More generally, the veto player theory suggests that policy stability is increasing in the number of partisan and institutional veto players, and in the ideological distances between them (Tsebelis, 2002). In a similar vein, Cox and McCubbins (2001) argue that there is a trade-off between the 'decisiveness' and 'resoluteness' of political systems, with a dispersion of power (power sharing) leading to reduced decisiveness.

However, the theory of veto players is concerned with policy change in general, not with efficient policy changes in particular, and although Tsebelis appears to claim that the theory's predictions about the former apply to the latter – since he has suggested that stability 'will make the change of even an undesirable status quo difficult' (Tsebelis, 2000: 443) – there are strong reasons to believe that we must move beyond the theory of veto players, at least in its current form, if we wish to develop an analysis of reform capacity, as defined here. The main reason is that the theory of veto players does not allow for the possibility that political agents may use side payments to compensate veto players who might otherwise oppose socially efficient reforms. This is an obvious solution to the problem of reform capacity since efficiency-increasing reforms by definition generate a surplus that can be distributed among the veto players. For example, as Stolper and Samuelson (1941: 73) noted in the conclusion of their classic article about trade liberalization, 'the harm which free trade inflicts upon one factor of production is necessarily less than the gain to the other. Hence, it is always possible to bribe the suffering factor by subsidy or other redistributive devices so as to leave all factors better off as a result of trade'.

The use of side payments to facilitate socially efficient reforms has been discussed extensively in economics (see Martini (2007) for a literature review), particularly in the context of trade liberalization (Castro and Coen-Pirani, 2003; Davidson and Matusz, 2006; Dixit and Norman, 1986). More generally, an important literature about the political economy of reform has developed in economics in the last two decades (Drazen, 2000), motivated largely by the Latin American experience in the 1980s and the Central and Eastern European experience in the 1990s (Olofsgård, 2003). A series of important studies have discussed issues such as the role of uncertainty about the benefits of reform (Fernandez and Rodrik, 1991), economic crises (Drazen and Grilli, 1993) and political polarization (Alesina and Drazen, 1991).

However, the discussion of political institutions in this literature is relatively limited and schematic. With a few exceptions (notably Scartascini et al. (2008), which is close in spirit to the current paper, examining intertemporal bargains between veto players using the theory of repeated games), economists who study reform do not consider the role of political institutions, and when they do, they tend to rely on simplifying distinctions between 'strong' and 'weak' governments (see, e.g., Alesina and Drazen, 1991). With respect to the issue of side payments, there have been few attempts to analyse the effects of political institutions on the ability of political agents to use side payments to facilitate reform, although some scholars have discussed the credibility of side payments and other redistributive promises more generally (Castro and Coen-Pirani, 2003 and Jain and Mukand, 2003).

3.3 When Power Sharing Works

The main reason why socially efficient reforms are not always adopted is that most institutions and policies matter to both efficiency and distribution (Knight, 1992; cf. Tsebelis, 1990). If a reform is socially efficient but not Pareto-efficient, it will only be adopted if those who expect a net welfare loss (the 'losers') are either defeated (allowing the government to ignore their objections) or compensated (by offering them a side payment that makes them net winners of reform). If power is concentrated, the government is free to follow the first course, adopting socially efficient reforms without considering the distributional effect on other agents. Although a concentration of power may be associated with other problems (such as higher levels of protest activity; see Nam (2007)), I will assume, for the purposes of this paper, that it is a feasible solution to the problem of reform capacity. The question is whether power sharing is *also* compatible with high reform capacity.

We can think of a side payment as a monetary transfer from the winners to the losers, or, more realistically, as the adoption of another policy reform, separate from the first reform, that benefits the losers at the expense of the winners (Castro and Coen-Pirani, 2003). For example, in the area of labor market policy, a reduction in employment security may become acceptable to wage earners if it is accompanied by policies that support workers who lose their jobs, such as unemployment compensation or investments in active labor market programs (Pontusson, 2005).

If side payments are in principle possible, and if political agents have identical preferences over Y (see Section 3.1), then there are three potential explanations for the fact that governments sometimes fail to adopt socially efficient reforms.

1. Political agents are unaware that existing policies are inefficient.
2. Political agents are aware that existing policies are inefficient, but reform is not Pareto-optimal, and political agents fail to identify a suitable side payment to politically influential 'losers'.
3. Political agents are aware that existing policies are inefficient, but reform is not Pareto-optimal, and although political agents identify a suitable side payment to politically influential 'losers', the 'winners' cannot credibly commit to this side payment.

The first explanation is that some political agents are unaware that the efficiency of public policies can be increased. The literature on welfare-state reform in Europe suggests that this is often the case. For example, Cox (2001) has argued that reforms are only possible when political actors manage to formulate a reform 'discourse', and Vivien Schmidt has claimed that governments must create a 'consensus for change', enabling the general public to 'change its perceptions of self-interest' (Schmidt, 2002: 169). However, this information problem exists in all political systems, regardless of the degree of power sharing.

The second explanation is that political agents fail to identify a suitable side payment, either because of a lack of communication between winners and losers or because the deadweight costs associated with making side payments exceed the efficiency gains from reform. However, the first of these problems should not be impossible to overcome, especially not in what Birchfield and Crepaz (1998: 182) have termed 'collective veto points', which 'emerge from institutions where the different political actors operate in the same body and whose members interact with each others on a face to face basis' (coalition governments and legislatures are two examples). The second problem should also be possible to overcome; concerning trade liberalization, for instance, Davidson and Matusz (2006) have argued that the costs for compensating the losers are relatively low (provided that the right instrumens are used).

The third explanation is that under some political institutions, and in some party-political environments, it is difficult for political agents to solve the commitment problems that are inherent in bargaining over reform. Political institutions may generate – and solve – commitment problems in several different ways. Most importantly, for our purposes, under some institutions reform packages cannot be implemented all at once, so actors may have reason to fear that their adversaries will block further reform once their own preferred policy changes are implemented (Ross and Ward (1995); for an empirical application in political science, see Hellman (1998)).

The next section highlights two sources of bargaining problems. First, in the absence of perfect control over policy implementation – which can be seen as an important consequence of having institutional veto players with whom the veto players who share power cannot strike quid pro quo deals (cf. Birchfield's and Crepaz's distinction between 'competitive' and 'collective' veto points, mentioned above) – the 'losers' will be reluctant to support reform if there is a risk that their own preferred policy will not be implemented. Second, if the 'losers' fear that they may lose veto player status in the future, they will be reluctant to support reform packages, since future veto players will only have reason to consider the wishes of agents who have veto player status at that time. The implication of this argument is that we must consider three dimensions of institutions in order to analyse the problem of reform capacity: the degree of power sharing (that is, the number of veto players), the government's control over the implementation of policy, and the stability of power sharing arrangements (that is, the set of veto players) over time.

4. Three Models of Institutions and Reforms

4.1 Assumptions

Consider a society where citizens are divided into two social groups, which are represented by two political parties: A and B. One may also think of A and B as interest organizations, or, perhaps most realistically, as coalitions of interest organizations and political parties (for instance, we can think of A as a trade union and a left-wing party with identical policy preferences and of B as a business organization and a right-wing party with identical policy preferences). In any real society, there are more than two parties and more than two social groups, but it is relatively straightforward to generalize the simple theoretical results presented here to more complex social and political environments.

Assume that A or B are both veto players in the sense that both players can prevent any policy changes relative to the status quo. As I noted in the previous section, I will assume that reform capacity is not a problem if either A or B holds power single-handedly, as governing parties do in unitary countries with just one veto player, such as the United Kingdom for most of the post-war period. The question I am trying to answer is under which conditions reform capacity is as high under power sharing as it is when power is concentrated.

The political process in the models that I present is highly stylized. The first thing that happens is that A proposes a *reform*, which has two types of effects. First, it has an effect on the welfare of both A and B, captured by the efficiency parameter y (which is a payoff that A and B receive if the reform is enacted). Using the terminology introduced in Section 3.1, we can define y in the following manner:

$$y = \frac{Y(P_r) - Y(P_s)}{2}.$$

If $y > 0$, A's reform program will increase social welfare (defined, crudely, as the sum of payoffs to A and B); if $y < 0$, it will decrease social welfare; if $y = 0$, it is neutral to social welfare. Since this paper is concerned with socially efficient reforms, it is assumed that $y > 0$.

Second, the reform has an effect on the distribution of post-reform welfare. This effect is captured by the distribution parameter α, which represents a bias in A's favour. In other words, if the reform is enacted, A gets the payoff $y + \alpha$ and B gets the payoff $y - \alpha$. A high α implies a high degree of distributional conflict. Since, as the analysis below will show, there is no impediment to reform if α is very low, we can think of reform capacity as the capacity to overcome distributional conflicts.

The parameters y and α are known by both players, and given exogenously. In similar models in economics, the α-term is interpreted as a measure of polarization in the political system (Alesina and Drazen, 1991). In the present case, we can think of α as a function of two factors: not only overall political polarization (for any given economic or social problem, political agents in a more polarized system can be expected to propose solutions with more radical distributional outcomes), but also the specific economic or social problem that the reform is intended to solve (some problems require more radical measures than others). If we assume that α is strictly increasing in political polarization, the interpretation of the model becomes comparable to related work in economics.

If $y < \alpha$, B is a net loser from A's proposed reform. Knowing that in these circumstances B will block reform, A may choose to offer B a side payment, which we can denote β. It is assumed that A can costlessly transfer resources to B. A richer model would include the (deadweight) costs of taxing A in order to compensate B, as in Aghion et al. (2004) and Castro and Coen-Pirani (2003), but this extension of the model would only change the results very slightly, as long as we assume that the deadweight costs associated with compensation are relatively small compared with the efficiency gains associated with reform.

In order to simplify the analysis as much as possible, I will assume that the utility functions of A and B are linear, additive functions of y, α, and β, so that $u_A = y + \alpha - \beta$ and $u_B = y - \alpha + \beta$ in the event of reform and $u_A = u_B = 0$ otherwise. In other words, the utility that both players derive from status quo policies is normalized to 0.

The final two assumptions are that the side payment cannot be negative and that A will never offer a side payment larger than $y + \alpha$. In other words, the minimum value of β, denoted by β_{min} is 0 and the maximum value of β, denoted by β_{max}, is equal to the maximum side payment that, if implemented, would give A a non-negative payoff from reform:

$$\beta_{\text{max}} = y + \alpha.$$

The idea behind these assumptions, which are crucial for the results, is that there are some exogenously given limits on the side payments that political agents can make (or accept). Specifically, the assumption is that no political party can credibly commit to a reform package that, if implemented, would make it a net loser from reform. This risk aversion may be explained by the expectation that such outcomes would be unacceptable to the party's rank and file and therefore very costly to party leaders.

4.2 A Simple Game of Reform

Consider a simple, baseline model where efficient reforms are always adopted. The *Simple Reform Game* has the following structure.

1. A proposes a reform, which if adopted will improve aggregate welfare, giving A a payoff of $y + \alpha$ and B a payoff of $y - \alpha$. Making the proposal, A simultaneously offers a side payment, β.

2. B decides whether to accept the policy package proposed by A (that is, the reform plus the side payment, if any).

Then the game ends, with payoffs $(0, 0)$ in the event of non-reform and $(y + \alpha - \beta, y - \alpha + \beta)$ in the event of reform.

The Simple Reform Game can be solved with backwards induction and has a unique subgame perfect equilibrium. It is easy to see that in stage 2, B accepts A's proposal if

$$\beta \geq \alpha - y. \tag{1}$$

If $\beta < \alpha - y$, however, B does not accept (I assume throughout the paper that A and B choose to support reform if they are indifferent between reform and non-reform). In stage 1, A therefore sets β to the minimum value that is sufficient to make B agree, which is either 0 or $\alpha - y$. Since $y > 0$, $\alpha - y$ can never be larger than $\beta_{\max}$, which means that A is always able to offer a sufficiently large side payment. Consequently, efficiency-increasing reforms are always adopted in equilibrium.

PROPOSITION 1. *There is a unique subgame perfect equilibrium in the Simple Reform Game. The equilibrium has the following properties:*

If $\alpha \leq y$, A sets $\beta = 0$ and B accepts A's offer.
If $\alpha > y$, A sets $\beta = \alpha - y$ and B accepts A's offer.

4.3 The Implementation Game

I will now introduce some institutional complexity in order to identify the conditions under which power sharing – having more than one veto player – leads to a reduction in reform capacity. The Simple Reform Game assumed that the government has full control over the implementation of the side payment β and that all agents can commit to the reform bargain. The next two models will consider what happens when these assumptions are relaxed.

First, consider the *Implementation Game*. In this game, the two stages in the Simple Reform Game are followed by a third stage, where an external administrative agency, court, second chamber, international organization or sub-national government chooses with some known probability whether to implement the side payment β. It is useful to think of this probability, denoted p, as a measure of the central government's degree of control over the implementation of policy. The discussion will concentrate on the case of federalism – that is, it will consider the possibility that sub-national governments have some say over implementation – but the argument can easily be transposed by substituting 'the bureaucracy', 'the judiciary', 'the upper chamber', or 'the European Union' for 'a sub-national government'. The general idea is that whenever an outside agent has some influence over the implementation of the agreement between *A* and *B*, this will matter to the initial bargaining situation.

3. A sub-national government decides whether to implement the side payment β. With probability p, the side payment is implemented; with probability $1 - p$, it is not.

With probability $1 - p$, therefore, *B*'s payoff in the event of reform will be $y - \alpha$, even if *A* and *B* have agreed to set $\beta > 0$ in the first two stages of the game.

It is easy to show that *B* will now only accept *A*'s proposal if

$$\beta \geq \frac{\alpha - y}{p}. \tag{2}$$

A comparison between Equations (1) and (2) shows that one can think of the Simple Reform Game as a special case of the Implementation Game, where $p = 1$.

As in the Simple Reform Game, *A* always prefers reform to non-reform, but in the Implementation Game *A* is sometimes unable to offer a sufficiently large side payment. This occurs if the value of β that is necessary to persuade *B* to support reform is larger than $\beta_{\max}$, which gives the following condition for reform:

$$p \geq \frac{\alpha - y}{\alpha + y}. \tag{3}$$

PROPOSITION 2. *There is a unique subgame perfect equilibrium in the Implementation Game. The equilibrium has the following properties:*

If $\alpha \leq y$, *then A sets* $\beta = 0$ *and B accepts A's offer.*
If $\alpha > y$ *and*

$$p \geq \frac{\alpha - y}{\alpha + y},$$

then A sets

$$\beta = \frac{\alpha - y}{p}$$

and B accepts A's offer.
If $\alpha > y$ *and*

$$p < \frac{\alpha - y}{\alpha + y},$$

then A is unable to offer a sufficiently large side payment, and B declines any offer A makes.

Clearly, there are equilibrium reforms for a smaller set of parameter values in the Implementation Game than in the Simple Reform Game, where socially efficient reforms are always adopted in equilibrium (see Proposition 1). One useful way to interpret the solution to the Implementation Game is to treat the maximum level of distributional conflict that is compatible with the adoption of socially efficient reforms in equilibrium – which we can call α^* – as a function of the potential efficiency gains (y) and the government's control over the implementation of adopted policies (p). Equation (3) implicitly defines this critical value:

$$\alpha^* = y\frac{1+p}{1-p}.$$

It is easy to see that α^* is increasing in y, which makes sense since larger gains from cooperation should make reform more likely. It is also easy to see that α^* is increasing in p, which suggests that high reform capacity can more easily be maintained under power sharing if the government has a high level of control over policy implementation.

4.4 The Election Game

Now, consider another extension of the Simple Reform Game: the *Election Game*. In this game, with a certain probability either A or B loses veto player status after an agreement on reform, and if A becomes the sole veto player after the election (or whatever other mechanism allocates veto power), A can and will ignore any promises concerning side payments, setting $\beta = 0$. In other words, the first two stages in the Simple Reform Game are followed by a third stage:

3. Elections are held. With probability q^A, A becomes the sole veto player after the election and with probability q^B, B becomes the sole veto player after the election. If A becomes the sole veto player, A sets $\beta = 0$.

Begin by considering B's decision situation (stage 2). Now B will accept A's proposal if

$$\beta \geq \frac{\alpha - y}{1 - q^A}. \tag{4}$$

A comparison between Equations (1) and (4) shows that one can think of the Election Game as a special case of the Simple Reform Game, where $q^A = 0$ (that is, where B is certain of remaining a veto player in the future).

Since A always prefers reform to non-reform, the question is whether the right-hand side of Equation (4) can ever be larger than $\beta_{\max}$, which – as in the

Implementation Game – would make it impossible for A to make a sufficiently large side payment. The condition for reform is

$$q^A \leq 1 - \frac{\alpha - y}{\alpha + y}. \tag{5}$$

The results are summarized in Proposition 3.

PROPOSITION 3. *There is a unique subgame perfect equilibrium in the Election Game. The equilibrium has the following properties:*

If $\alpha \leq y$, then A sets $\beta = 0$ and B accepts A's offer.
If $\alpha > y$ and

$$q^A \leq 1 - \frac{\alpha - y}{\alpha + y},$$

then A sets

$$\beta = \frac{\alpha - y}{1 - q^A}$$

and B accepts A's offer.
If $\alpha > y$ and

$$q^A > 1 - \frac{\alpha - y}{\alpha + y},$$

then A is unable to offer a sufficiently large side payment, and B declines any offer A makes.

There is a non-empty set of parameter values for which there is no reform in equilibrium in the Election Game. In order to facilitate the interpretation of the results, we can treat the maximum degree of distributional conflict that is compatible with the adoption of socially efficient reforms in equilibrium, α^{**}, as a function of the potential efficiency gains (y) and the probability that A becomes the sole veto player (q^A). Equation (5) implicitly defines this critical value:

$$\alpha^{**} = y\frac{2 - q^A}{q^A}.$$

Clearly, α^{**} is increasing in y. In other words, the higher the gains from reform, the more distributional conflicts the system can handle, which makes intuitive sense. It is also easy to see that α^{**} is decreasing in q^A. This result has a natural interpretation. An imbalance in the expected future political power of veto players is an impediment to reform since it introduces a commitment problem into political bargaining. If both players are reasonably certain that they will remain veto players in the future, or if the losers are reasonably certain that they will remain veto players in the future, reform capacity is high since both players will be able to commit to future policies. This result mirrors a more general result in economics, according to which ‘political turnover can induce policy makers to resist making public investments which entail short-run costs, if the future gains are contingent on actions of future policy makers’ (Besley and Coate, 1998: 147).

However, this is a somewhat paradoxical result from the point of view of veto player theory, as in this game, the expectation that the same parties that are veto players at time t will also be veto players at time $t + 1$ makes reforms at t more likely. In other words, it may not be a disadvantage, from the point of view of reform capacity, to have more veto players, if all parties that participate in political bargaining expect to keep their seat at the bargaining table in the future.

5. Conclusion

This paper has argued that a country’s reform capacity, defined as the extent to which institutions facilitate the adoption of socially efficient reforms, is not necessarily decreasing in the number of veto players. However, when faced with conflicts of interest, political agents will find it easier to identify mutually beneficial reform packages in political systems with high political stability and a concentration of policymaking competencies at one level of government.

In systems with many veto players, reform capacity thus depends on the availability of side payments. In *The Semisovereign People*, Schattschneider (1960) noted that one of the crucial issues in politics is the scope of conflict: how many actors, and what actors, are involved in a political struggle. Similarly, to understand the room for cooperation and compromise in democratic politics, we need to consider the scope of *government*: what policy areas, or items, are on the political agenda. Where political decisions involve one, separate policy area, without the possibility for actors to make package deals, conflicts will be divisive and reform capacity will be low unless power is concentrated. Where actors have the possibility of linking issues, however, it will be easier to pursue common interests, as with a large number of items on the agenda there will often be trade-offs available.

I have kept the theoretical model quite simple, and I hope to extend it in future work. The most significant limitation of the paper is that the model does not have an electoral dimension. The preferences of voters are not modelled explicitly. Incorporating the preferences and actions of voters is an important task for future research. Another way of extending the model is to make it more dynamic. Taken together, the solutions to the Implementation Game and the Election Game suggest that there is a dilemma in the politics of reform. It follows from the solution to the Election Game that it may be easier to achieve reform if reform packages are designed to guarantee future veto power to present veto players, perhaps by giving them power over the implementation of the policy programs involved in the reform. On the other hand, the solution to the Implementation Game suggests that this may be an impediment to future reform, since it increases the fragmentation of the political system. This is arguably a real dilemma in many European countries, where the 'corporatist' structures that were created to facilitate post-war reconstruction and political coordination in the 1940s, 1950s, and 1960s sometimes became a source of gridlock and political stalemates in the period of economic crisis and austerity that began in the 1970s (see Hemerijck (1992) for a discussion of the Dutch case, which is arguably an example of such a process). A dynamic model with endogenous institutional choice is another natural extension of the argument developed in this paper.

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