

Draft, September 15, 2003

**Coalition Governance Theory:
Bargaining, Electoral Connections and the Shadow of the Future**

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Prepared for Kaare Strøm, Wolfgang C. Müller, and Torbjörn Bergman (eds.) **Coalition Governance in Western Europe**. Forthcoming from Oxford University Press. We thank James N. Druckman, Jesse Menning, Gisela Sin, and participants at Coalition Governance conferences in Vienna, Siena and Canterbury for helpful suggestions. Professor Lupia acknowledges the support of the Center for Advanced Study in the Behavioral Sciences.

1. Introduction

A coalition is a team of individuals or groups that unites for a common purpose. In many countries, such teams coalesce for the common purpose of running a government. When this occurs, coalition members share the responsibility of converting a wide range of social demands into a manageable set of state-sanctioned activities.

While working for a common cause, coalition members may also have disagreements. Some come from coalition members attempting to please different electoral constituencies (e.g., members who represent urbanites want different policies than members who represent rural regions). Conflicts also arise when multiple coalition members crave a particular seat of power (e.g., prime minister). Even when coalition members agree on broad policy goals, they can differ on how to govern.

How coalition members cultivate common interests and manage internal conflicts determines the fate and effectiveness of every governing coalition. Such decisions affect the quality of governance in democracies around the world. It is worthwhile, therefore, to ask: Can social and scientific understanding of coalition governance be increased? We argue that the answer is “yes.”

In this chapter, we present an approach to studying coalition politics that yields new insights about governance. Like later chapters in this book, our main concern is governance in the parliamentary democracies of Western Europe. Here, we address this concern by producing a theoretical framework that yields clarifying generalizations about governance in these nations.

Generalizing about coalition politics is no trivial matter. Every country is unique and challenges those who govern it with a unique mix of historical precedents, democratic principles, social conventions, and popular demands. It is natural, therefore, to expect that clarifying accounts of one country’s coalition politics will seem bizarre if applied elsewhere.

Consider, for example, the coalition politics of Italy, which in the post-1945 period has averaged approximately one new cabinet every 13 months. This frequency of coalitional change is the highest in Western Europe and more than twice the average for the region (Müller and Strøm 2000: 561). If a

theoretical framework can explain important aspects of coalition governance in Italy, can we use it to better explain coalition governance in other places? Throughout this book, we answer “Yes.”

Our theory of coalition politics builds from the premise that parliaments are deliberately organized to recognize and reinforce a central role for political parties (Müller 2000).¹ Hence, we clarify important aspects of coalition governance by focusing on how political parties juggle the interests of constituents and coalition partners when making critical decisions (e.g., coalition formation, policy making, ministerial replacements, and the timing of elections).

Our theory has five components. Four components come from established theoretical frameworks for studying coalition governance. While these components are often used one-at-a-time, we produce additional insights by integrating them. The fifth component, our theory’s backbone, provides the means for integration. Components 1-4 are as follows:

1. Country-specific factors, while important, are not the whole story.

A venerable tradition in the social sciences emphasizes the uniqueness of the contexts in which social and political decisions are made. These accounts tend to highlight country-specific factors. They seek causality in aspects of a country’s culture and history. Applied to the Italian propensity for cabinet turnover cited above, such accounts privilege particularly Italian explanations such as its late unification, its culture of distrust (Banfield 1958), or the legacy of fascism.

Other accounts in this tradition stress the path dependence of social events. They claim that political decisions are so heavily conditioned by past choices that there can be no meaningful comparisons across political settings with different histories (Thelen and Steinmo 1992). If this claim is correct, then the implication for scientific work is that once an analyst controls for cross-national differences, there is little

¹ The behavior of political parties can, in principle, be understood as an interaction between party members, officers, and activists. Yet, any systematic and tractable version of such an account is beyond the grasp of current social science. Thankfully, political parties are typically sufficiently institutionalized and hierarchical that many of their behaviors can often be understood as if they were those of a person. So, throughout this book, we assume that we can treat parties, or more specifically their parliamentary leaderships, as if they were unitary actors (see Laver and Schofield 1990; for a more elaborate defense see Müller and Strøm 1999, ch. 1).

left to explain. In this and subsequent chapters, we show that while country-specific effects can be important, they do not provide the whole story.

2. Resource distributions among political actors, while important, are not the whole story.

Some observers contend that bigger is always better; that power in coalitions is due entirely to money, brute force, or, in the case of parliamentary politics, the number of legislative seats that a party controls. In this view, more resources imply greater political success. Hence, the most important asset that a political party can bring to the political bargaining table is the size of its parliamentary delegation, complemented, perhaps, by other currencies such as access to money. In the Italian case cited above, this approach can explain cabinet turnover as the consequence of a standoff between two powerful forces in Italian politics: the Christian Democrats and the Communists. While many observers argue that politics is dominated by the strong and the resourceful (e.g., Rokkan 1966, Miliband 1990), we show that such domination is neither inevitable, as a theoretical matter, nor sufficient to explain many past events.

3. Institutions, while important, are not the whole story.

Another view is that institutions drive coalition politics. A strong version of this view holds that a set of institutions (such as a proportional electoral system, a constructive vote of no confidence, a powerful legislative committee structure, or an investiture requirement) has consistent effects on coalition politics, regardless of national setting, resource distribution, or the personalities involved. In the Italian example, this view not only implies that electoral and legislative rules generate the high frequency of coalitional change, but also implies that if you changed the nationality of the participants, while leaving the institutions constant, the outcome would be the same. Institutional ideas are implicit in many writings on coalition government, including the “structural attributes” literature on cabinet duration (see, e.g., Browne et al., 1986, Powell 1982, and Lijphart 1999).

Institutions surely affect coalition politics. We concur with scholars such as Luebbert (1986, especially pp. 29-44) who claim that institutions privilege certain behaviors. We also agree that institutions can shape the expectations and preferences of political actors. But if institutions are the sole factor in

explaining coalition decision making, then the implication for empirical work is that once an analyst has controlled for institutional differences, there is little left to explain. Throughout this book, we clarify how institutional effects depend on, and are affected by, other factors.

4. Politicians' preferences, while important, are not the whole story.

Some observers contend that there is a direct link between politicians' preferences and coalition decisions, a link that cultural factors, resources, and institutions do not affect. One such argument for the Italian case is that preference divisions between Christian democrats, communists, and neo-fascists make coalition bargaining difficult – and that such interests would clash under any institution, political resource distribution or flag. Another manifestation of this idea is that if two parties share common policy agendas (or have policy ideal points that are close to one another), then they will have a stronger, more effective, and longer-lasting coalition than will coalitions with less common agendas (De Swaan 1973, Warwick 1994). In this and the chapters that follow, we argue that while preference-based hypotheses have explanatory power in some circumstances, in other cases they either explain very little or yield mistaken conclusions.

5. Bargaining Requirements Provide an Organizing Framework

Each of components 1-4 isolates a determinant of coalition behavior. When applied collectively under a unifying framework they can teach us even more. Our theory's fifth and final component provides a means of unification. Component 5 begins with the fact that all coalition members, regardless of country, resources, institutions, or preferences, face a common problem: to reap the benefits of governing, they must satisfy two requirements simultaneously:

- 1. Form and maintain agreements with other parties.**
- 2. Please voters.**

These requirements are a consequence of democratic competition. Parties must compete with each for voter support at the same time that they compete with each other for legislative control. Satisfying both requirements simultaneously is necessary coalition survival. Parties that fail to cultivate voter support are

replaced in parliament by parties that succeed, while parties that fail to maintain coalition agreements are replaced in cabinets by parties that can.

Satisfying *the two requirements of coalition participation* is seldom easy. It is very difficult when a party's electoral constituents and (real or potential) coalition partners want different things. It is even more difficult when a party's political goals – such as enacting a broad or wide-ranging policy agenda – necessitate both requirements being met for a long time.² Coalition members in such circumstances have an incentive to engage in coalition bargaining thinking not just about their present desires, but also about *the shadow of the future* (i.e., the likely reactions of voters and political opponents).

This representation of coalition politics is the backbone of our theory. ***Coalition decisions are the result of bargaining in the shadow of citizen opinions and the constant threat posed by political rivals who want to replace them.*** The negation of our approach is manifest when attempts to explain coalition governance turn a blind eye to the necessity of bargaining, the anticipated response of the electorate, or the shadow cast by groups that can impair an existing coalition. While removing such factors can simplify analyses, the cost of simplification is often erroneous conclusions about coalition governance.

Our bargaining-based theory clarifies how each of the components listed above influences coalition decisions. It answers important questions about when one component (i.e., country-specific attributes) dominates another (i.e., institutional) and about how uncertainty affects all components. Our integrative approach explains critical decisions made by governing coalitions in many countries.

This chapter continues as follows. In Section 2, we introduce and apply the theory. In Section 3, we use the theory to correct errors in widely held beliefs about the timing and nature of a coalition's decision to terminate. Section 4 summarizes our findings.

² Consider, for example, tax schemes intended to promote investment or any policy that requires costs paid now in exchange for future benefits. If potential investors perceive a coalition government as unwilling or unable to keep future promises in adverse conditions, they may be less likely to contribute or make sacrifices in exchange for such promises. Indeed, economic downturns may make it extremely expensive to live up to commitments made in rosier times and new

2. Bargaining: The Engine of Coalition Governance

Coalition decisions are the product of agreements between coalition members – each of whom must satisfy the two requirements of coalition participation if they want to remain on the team. Bargaining is the means by which such agreements are usually reached. The goal of our theory is to clarify fundamental aspects of coalition bargaining. We introduce its main elements in the context of answering simple questions about coalition governance. As this chapter proceeds, we engage increasingly complex questions. Throughout, we denote key concepts in **bold**.

The theory's main premises are as follows:

1. Bargaining is the means by which parties attempt to satisfy the first requirement of coalition participation – to form and maintain agreements with other coalition partners.
2. Who prevails in coalition bargaining depends on what political parties can offer to one another. Which offers parties will make and accept depends – in a particular way -- on country-specific factors, institutions, party preferences, voter support, and party leaders' beliefs about an uncertain future.
3. Voter support – the second requirement for coalition participation – in turn depends on the qualities of the agreements that parties strike.

Bargaining is a process by which actors engage in communication for the purpose of finding a mutually beneficial agreement. Bargaining is required to reach such agreements, if

- there exist individual benefits that can only be achieved through collective action,
- if there are multiple ways of distributing the benefits associated with such actions, and
- no actor can simply impose a collective arrangement upon everyone else.

By **individual benefits** we mean that potential partners can accomplish more when working a coalition than they can when working without coalescing (i.e., party 1 acting alone can produce social output X , party 2 acting alone can produce social output Y , the parties acting together can produce social output $Z > X+Y$, and there is a way to distribute the benefits of Z such that parties 1 and 2 are happier than if each had acted alone). Policy decisions, legislation, military operations, enforcement of laws and property rights help coalition members satisfy their goals, but often require coalescence (i.e., a party without the

challenges or challengers may make political parties reconsider their previous priorities. Yet, the nature of coalition agreements is precisely to constrain parties from making such changes in their priorities.

support of a legislative majority – party 1 or 2 acting alone in the example above -- can make no new laws, while a party who has such support – the coalition between parties 1 and 2 -- has this ability). For nations to accomplish goals both essential and mundane, some group of factions or parties must reach agreement about what to do.

Parties can bargain for benefits only because citizens delegate policy-making authority to them. These delegations, however, do not allow parties to bargain as they please. **The electoral connection** – the threat that voters will judge coalition members eventually – governs member behavior. Fears of voter backlash constrain parties to reach only certain kinds of agreements.

A challenge to every coalition is that there are usually **multiple ways to distribute the individual benefits associated with coalescence**. If public problems allowed only one solution, then coalition politics would be simple (and not very interesting). The only question would be whether or not to employ the solution – a relatively simple bargaining problem. But such simplicity is rare. More often, there are many ways to distribute social resources, many different policy platforms that a majority of MP's can support, and more politicians desirous of high office than offices available. If the different means of achieving a collective goal vary in the costs and benefits they imply for individual coalition members, then members can have different preferences about what the coalition should do. Bargaining is the means by which such conflicts are managed.

Contracts are the usual currency of bargaining. Contracts are agreements, oral or written, in which participants commit to certain actions in return for specified benefits. A contract's purpose is to clarify terms of agreement, delineate punishments for noncompliance and rewards for compliance, and reduce risk. Since bargaining can require substantial time and effort, **bargaining costs** are an essential part of coalition politics. When negotiators have limited time and energy and regard these resources as valuable, they will perceive bargaining as costly.

What can we learn about coalition governance from a theory based on the premises listed above? Our initial answer to this question will come in the context of explaining why parties coalesce at all. Once

we establish that parties have strong incentives to form and maintain lasting coalitions, we use the premise that bargaining is essential and costly to study the key decisions that standing coalitions make.

Why Coalesce?

Many countries are governed by self-recognized coalitions of political parties. Why does this happen? Commitment to a coalition agreement may impose personal costs (i.e., the loss of voter support associated with a legislative compromise). Given that the world is unpredictable, why shouldn't political parties to just drop in and out of free-floating majorities? The advantage of such a strategy is freedom – parties need not be burdened by a more permanent coalition partner's demands. Prevailing against such freedom, however, is a host of problems and inefficiencies including:

- *Increased bargaining costs.* Free-floating majorities force participants to negotiate every decision anew. The time and energy needed to proceed in this manner can exhaust a party's resources and reduce its abilities to accomplish multiple goals.
- *Less policy continuity.* Why should the majority that forms on a Tuesday morning enforce the laws made by Monday evening's majority? If there were no legislative continuity, the costs to anyone with a long-term interest in a society would be tremendous. Imagine, for example, imagine what buying a house or investing in stocks or an education would be like if basic property rights were subject to frequent change. For people attempting to base social, political, or economic plans on government policies, free-floating majorities spell disaster
- *Less outside support for government programs.* For most government policies to be effective, people outside of government must cooperate. Citizens must abide by certain laws, businesses must adhere to the terms of certain contracts, and countries must act within the terms of certain treaties. If a government cannot credibly uphold agreements tomorrow that its leaders sign today, anyone who deals with that government has less incentive to trust or cooperate with it. Alternatively, even if a free-floating majority were in power long enough to name cabinet ministers, there is no reason to expect others in government to abide by ministerial directives. For example, bureaucrats who dislike today's

legislative directives may have an incentive to disregard them if they believe that tomorrow's governing coalition will change the law in ways that they prefer (see, e.g., Huber 1998, Huber and Lupia 2001 on the link between cabinet stability and bureaucratic action).

- *Less reliable voter support.* If voters prefer a government whose actions are at least somewhat predictable, then politicians who can credibly commit themselves to something other than a transitory coalition stand to gain. Standing coalitions can tie parties to specific policies, which gives voters a reason to differentiate between candidates for office. Members of persistent coalitions can also more easily establish "policy brand names" that reduce citizens' uncertainty about the policy consequences of voting for a particular candidate (Cox and McCubbins 1993). Indeed, standing coalitions make it easier for voters to hold government officials accountable for their actions than would free-floating majorities.

In sum, formalized, stable coalescence is a survival strategy – it provides parties with the ability to influence government decisions, earn the trust of non-governmental actors, and maintain good relations with voters over extended periods of time. Because such relations are more important than the policy freedom that free-floating coalitions could allow, standing coalitions tend to govern west European parliamentary democracies.

Walk-Away Values

In what follows, we begin with a simple scenario in which parties are certain about the future. This simplification clarifies important aspects of coalition bargaining with minimum effort. We then move to more realistic settings where parties bargain in the shadow of an uncertain future.

In the simplest economic bargaining models, everybody knows everything. When applied to coalition governance, such models imply that every party leader knows everything about the situation at hand -- such as the preferences, options, and constraints of each party leader – both at the time of negotiation and forever into the future. In such a world, negotiators anticipate all consequences of their actions and bargainers can engage in **complete contracting**. Complete contracts allow coalitions to specify in detail what each partner will do in any circumstance.

Of course, governing coalitions seldom know so much. However, examining some properties of complete contracting is an efficient way to uncover key insights about coalition governance. Consider, for example, the question of who prevails when coalition members disagree. In bargaining models, the answer to this question hinges on the credibility of a bargainer's negotiating position. We call this factor a **walk-away value**. A walk-away value is what a negotiator, such as a party leader, can gain without any new collective agreement; i.e., what he or she secures by walking away from the bargaining table. Economists also use the term reservation wage to describe this concept (see, e.g., McMillan 1992).

In a bargaining session, walk-away values function as implicit threats against other parties. The more easily a party can walk away from the bargaining table and still end up in a good situation, the more concerned the other parties have to be about satisfying that party's demands -- if they want to coalesce with it. Put another way, those who have little to lose from disagreement often have much to gain from negotiation.

In economic contexts, walk-away values are usually determined by the monetary values of other opportunities in a market economy. For example, a worker who can earn high wages from many employers has a higher walk-away value than a similarly situated worker with no outside opportunities. The source of walk-away values in parliamentary contexts often lies elsewhere.

In democracies, **public support is the lynchpin of a political party's power**. Parties who lack public support can make no promises that are of value to other potential coalition partners.

While public support is necessary for a party to have a positive walk-away value, it is not sufficient. For a party to have a positive walk-away value, it must be able to benefit from its assets (including its public support) without tying itself to any specific coalition agreement. For example, when one party has enough seats to govern on its own, only it has a positive walk-away value (i.e., only it can govern without the help of others). When no party has resources (i.e., seats) sufficient to govern alone, walk-away values are determined by which party combinations are capable of governing (i.e., which teams of parties can control a number of seats sufficient to win votes in a parliament). Parties that can be members

of more than one governing coalition can have positive walk-away values and increased bargaining leverage (i.e., Party X gets bargaining leverage if other coalition members believe that failure to please X will lead it to leave the existing coalition and join another majority). Indeed, if a party can maintain a credible exit threat throughout a coalition's term (i.e., if by defecting it can bring down a government and produce a situation where it benefits), then we expect it to have great influence over a wide range of governance decisions. The religious bloc in the Israeli Knesset has such power – it can, and has, coalesced with either Labour or Likud – and regularly gets its way on social policy though it never holds anywhere near a majority of seats.

Coalition decisions depend on how parties evaluate the walk-away values of actual and potential partners. Understanding this fact clarifies many aspects of coalition behavior – including the errors inherent in the common belief that resources, such as number of seats held, transfer directly into bargaining power. Many people believe that the larger a party is, the more powerful it is in coalition negotiations. This belief is true only in cases where walk-away values and size are positively correlated. In such cases, we expect allegiance to “parity norms” – agreements where a coalition member's share of portfolios corresponds to its size relative to other coalition members. When walk-away value and size are less correlated, we expect parity norms to be abandoned.

To see how size and walk away value can differ, consider a simple example. Three parties have seats in a 101-member parliament that uses simple-majority-rule to make decisions. Party A has 50 seats, Party B has 48 seats, and Party C has 3 seats. For policy reasons, all parties prefer certain coalitions to others. Suppose that all parties know not only these preferences, but also all other important aspects of the bargaining situation. Suppose further that any realized gains from coalescence are divisible among coalition members, that all parties prefer a larger share of power in a coalition to a smaller share, and that any party is free to negotiate with any other party. To simplify the example, we describe the case where any coalition including C produces substantial individual benefits to both coalition members, whereas a coalition including A and B produces no such benefits. Party C may be a centrist party whose members are not

repulsed by the policy desires of other parties and vice versa, while A and B have disagreements so fundamental that there is nothing that they that could agree to do together.

The result of bargaining in this case (following Lupia and Strøm 1995) is as follows:

- C has the fewest seats, but the largest walk-away value -- it is the only party that can threaten potential suitors that it will seek to be part of another value-generating coalition.
- Although A and B are much larger than C, and have positive walk-away values, their respective walk-away values are much less than their size alone would suggest.
- The only sustainable outcome involves a contract giving party C almost all of the power within the governing coalition.

In this simple example, size and bargaining power are not positively correlated. C, by far the smallest party, is the most powerful. The lesson here is that walk-away values trump size. Even though large parties often have larger walk-away values than small ones, **size is not always power**. This example is also interesting because it resembles West Germany in the 1970s and 1980s – where the Social Democrats and the Christian Democrats are like parties A and B, and the Free Democrats are like party C. Though smaller than the other two parties, the Free Democrats (FDP) wielded great bargaining power. Our theory implies that the FDP should have secured a disproportionate share of cabinet portfolios in the period specified, and indeed they did.

Walk-away values, however, do not affect coalition bargaining outcomes in isolation. **Institutions affect walk-away values**. Institutions such as size or composition rules, formateur/investiture rules (Huber and McCarty 2001), recognition rules (Bawn 1991, 1993) independence of the judiciary/civil service, cabinet operating procedures, and internal party rules affect coalition bargaining by constraining peoples' actions (Strøm, Budge, and Laver 1994). For a few years in the 1990's, for example, Israel's Basic Law transferred the first opportunity to form a coalition from the largest party in parliament to a separately elected Prime Minister. This institutional variation decreased the largest party's walk-away value in Knesset negotiations if it did not also win the Prime Minister's race. This institutional change was sufficient

to affect whether its defense policies were left or right of center (i.e., whether Labour or Likud was in the coalition). In Belgium, the constitution requires linguistic parity in the cabinet, which constrains coalitions to contain both Flemish and Walloon parties. This requirement affects which coalition agreements parties can credibly walk away from. In sum, if institutional constraints also affect parties' walk-away values, then they can affect what coalitions do.

Understanding the role of bargaining and, by implication, walk-away values, casts the actions of coalitions in a new light. Under majority rule, size need not be power in coalition governance. Unless a party earns more than one-half of the seats in parliament, its bargaining power depends on walk-away values. The same logic implies that **any institutional, resource-based, preference-based, or country-specific factor affects coalition agreements only if it affects a potential coalition partner's walk-away value**. In some nations, for example, cultural taboos make certain coalition agreements untenable to voters and can make parties' relative walk-away values different than in nations without such taboos.

Another common belief about coalitions is that if parties share common preferences, then they will coalesce. Simple logic from bargaining models shows why this belief is false. In short, **if the costs of reaching agreement with a particular partner are too high, then parties may cast agreements with that partner aside – opting instead for a less costly agreement with someone whose preferences are less common**. Indeed, if there are too many items to negotiate, or too many contingencies that might arise, (i.e., if the cost of bargaining with a particular partner is sufficiently high), then we cannot simply assume that parties with common policy interests will coalesce, or that the parties to a potentially beneficial agreement will even find it worthwhile to try. As Fudenberg and Tirole's (1991: 397) explain:

“A bargaining situation involves players who must reach an agreement in order to realize gains from trade. The standard example is the problem of sharing a pie. No player can have any pie until they all agree about the shares each will receive. Negotiating about the shares is costly, and the pie may decay or disappear if the negotiations go on for very long.”

Such concerns certainly ring true in parliamentary democracies. Bargaining can take considerable time. In the Netherlands, coalition formation negotiations often last at least three months and in 1977 lasted for the better part of a year! In the meantime, decisions on major political issues are suspended, the

government is reduced to caretaker status, and parties do not enjoy the perquisites of office. In such cases, there is no doubt that the “pie” decays as the parliamentary term passes and the next election approaches.

Uncertainty, Commitment, and Discount Rates

While high bargaining costs are sufficient to derail an otherwise successful bargaining session, other factors that can greatly impact coalition politics. Uncertainty is chief among these factors. A source of much uncertainty in coalition politics is *the two requirements of coalition politics*: the need to form and maintain agreements with other parties while simultaneously cultivating voter support. The first of these requirements introduces uncertainty because party leaders lack information about each other’s strategies. The second requirement introduces uncertainty because voters can be fickle and their preferences can be difficult to gauge and foresee.

We now describe coalition governance in cases in which parties lack the kinds of information just described. They may, for instance, lack information about what other parties want or what sacrifices they are willing in exchange for coalition membership. In such cases, parties may try to strengthen their bargaining position by overstating their walk-away values (e.g., to insist that you will settle for nothing less than ministries X, Y, and Z, when, in fact, you would be satisfied with two of the three). Therefore, **a key to bargaining under uncertainty is separating fact from fiction when assessing others' walk-away values.**

A complete account of what people believe about others' walk-away values would involve a fair amount of psychology. However, bargaining models built from the premises described above produce important insights about these cognitions with less effort (see, e.g., the review in Laffont and Tirole 1993). They show that **commitment** is the key to bargaining under uncertainty.

While any party can claim a high walk-away value, such claims are more credible if commitments back them. If, for example, a party leader can credibly commit to resigning his post if a particular objective is not achieved, then his coalition partners may have a greater incentive to give in (especially if they dislike

his potential replacement). Thus, actors who can credibly commit, can increase others' perceptions of their walk-away values and benefit in negotiation.

How do actors credibly commit? Some make public promises that are costly to contradict (Lupia and McCubbins 1998.) In 1979, for example, the Irish Labour Party adopted the Killarney Compromise, which removed the party leader's power to take the party into a coalition with another party (in this case, Fine Gael). From that time on, Labour's entry into a government coalition required ratification by a Special Conference. This commitment subsequently strengthened Labour's hand in bargaining (Marsh and Mitchell 1999).

In addition to lacking information about what other partners want now, parties may also lack information about the future. This shadow of an uncertain future makes discount rates a critical aspect of bargaining under uncertainty. A **discount rate** measures an actor's valuation with respect to time -- how much the enjoyment of a certain benefit today is worth relative to the enjoyment of future benefits. The more uncertainty an actor has about the future, the higher is his discount rate (i.e., the more he prefers benefits now to promises of future benefits). Discount rates also depend on other factors, such as how much parties care about the issues facing the government today.

Many studies clarify how discount rates affect bargaining (see, e.g., Kreps 1990). Their main lesson is that **patience is power**. For example, if one person can afford to wait longer than another for a particular good, then the more patient person can credibly commit to give up less in the present to receive the good. Put simply, greater patience implies higher walk-away values.

To show how discount rates affect coalition bargaining, we return to the three-party example given above. Here, however, we suppose that a formateur rule gives party A the first opportunity to form a government, followed by party B. Also suppose that Party A's and B's constituents are impatient, so that party A regards the benefits of agreements reached in a second or later period of bargaining as far less valuable than agreements reached in the first round. If the constituents of parties B and C are more patient,

then Party A has much to lose if it fails to make a successful offer in the initial round. In such a case, the greater is Party B and C's walk-away value vis-à-vis Party A.

Discount rates come into play when parties delegate authority to “term-limited” party leaders. Consider Ireland following the 1989 election. There, Charles Haughey, the long-time Fianna Fáil leader, in the twilight of his career, broke his party’s no coalition rule so that he could form a coalition government with the Progressive Democrats (PD). This was remarkable not just because it conflicted with the Fianna Fáil’s long-standing contempt for coalitions, but also because there was considerable bad blood between the leaders of the two parties. Analysts have suggested, however, that if Haughey had allowed negotiations to continue, he might have lost his last opportunity to become prime minister. Indeed, he might even have been deposed as leader of his party (Laver and Arkins 1990, Mitchell and Marsh 1999). Haughey had a high discount rate, which likely propelled him to negotiate an unconventional agreement.

One implication of how discount rates affect coalition bargaining is that **deadlines matter**. This is particularly important when a deadline affects parties differently. Consider, for example, Norway's 1987 Presthus debacle. The Parliament was about to take its summer recess. With no further meeting time scheduled, there was no opportunity for the non-socialist parties to topple Gro Harlem Brundtland’s Labor minority government before local and regional elections in September. Rolf Presthus was the leader of a Conservative party that had strongly committed itself to toppling the government. He felt compelled to defeat Brundtland’s government, even if it meant large policy concessions to prospective coalition partners and the risk of failure. As it turned out, Presthus’ attempt failed, and he paid a heavy political and personal price. The timing of his apparently self-defeating behavior suggests that he was driven by a high discount rate, by his need to show results before the election (Strøm 1994).

Indeed, those with low discount rates (i.e., parties that can afford to wait) can find it advantageous to use time strategically. Such parties may know that if they wait another week to come to an agreement, a desperate partner (perhaps one whose time as formateur is about to end) will offer them a much better deal. Therefore, we should be cautious about the conventional wisdom that **the time it takes a coalition to**

negotiate tells us something about the quality of governance. As Gregory M. Luebbert observed, “it is wrong to assume that, because interparty negotiations take a long time, much is being negotiated among the parties” (Luebbert 1986: 52). If people have differing preferences over time and use time strategically, the length of negotiations may reveal nothing about the policy differences between the partners or the likely success of the final agreement. Time does not imply craftsmanship in bargaining. Instead, bargaining models show that long negotiations are always a sign that at least one coalition partner is willing to be patient in order to get a more favorable contract (see, e.g., Fudenberg and Levine 1998 on the role of patience). The same models reveal no relationship between length of bargaining and the success of the agreement.

Uncertainty and the Role of Transaction Costs

In many respects, the future is uncertain. We address additional questions about how uncertainty affects coalition politics by focusing on transaction costs. A key tenet of transaction cost economics is that bargainers account for opportunism when making and maintaining coalitional arrangements. **Opportunism** arises when coalition members can use uncertainty to benefit at other members’ expense. Attention to opportunism is particularly important in agreements where one party receives benefits before another. In such cases, the party that gets its payoff early may be tempted not to uphold its end of the bargain later on. If coalition members anticipate such reactions and have no way to guard against them, then otherwise valuable agreements may not be reached.

Uncertainty and opportunism generate **transaction costs**, which Kreps (1990: 743) defines as follows:

“When undertaking a transaction, parties to the transaction must incur several sorts of costs... [some] costs are incurred before the transaction takes place. If the transaction is to be governed by a written contract, the contract must be drafted. Whether governed by a contract or simply by verbal commitments, the terms of the transaction must be negotiated. [Other] costs are incurred in consummating and safeguarding the deal that was originally struck.”

Many scholars have studied how transaction costs affect bargaining. Williamson's (1975) research is particularly influential. Before his work, numerous claims about the performance of markets and

negotiations were made as if transaction costs were negligible or could be ignored. It was believed that if potential gains from trade existed, negotiations would lead to their realization (present day versions of such arguments include the conclusion that parties with similar policy interests will necessarily coalesce and the conclusion that such coalitions will necessarily be more effective or longer lasting than others).

Williamson's transaction cost economics approach shows such beliefs to be false -- uncertainty and opportunism can prevent such outcomes. This work redirected analysts' attention to how people structure their arrangements when they are faced with an uncertain future (see, e.g., Williamson 1975, Epstein and O'Halloran 1999).

Williamson demonstrated that bargainers have incentives to adapt to transaction costs by structuring agreements in particular ways. For example, when uncertainty and the threat of opportunism generate large transaction costs, coalition members have an incentive to seek **restrictive arrangements** (i.e., contracts that provide coalition members with minimal flexibility). While restrictive arrangements may limit coalition members' future discretion, they can keep coalitions together in contexts of mistrust. In short, the threat of opportunism may force coalitions to choose between viability and flexibility.

Transaction cost economics also directs attention to the unusual role of **specialization** in coalition politics. The complexity of modern governance can provide parties and individuals with an incentive to specialize. For parliaments as a whole, specialization can provide broad benefits (e.g., certain members become so knowledgeable about a complicated subject that they can simplify the topic for all other members). While specialization can be valuable those with expertise, greater expertise need not imply an advantage in bargaining. In fact, the prospect of opportunism by other members can lead to a negative relationship between expertise and walk-away values.

In Germany, for example, the FDP has been a member of several governing coalitions -- some dominated by the left and others by the right. Switching sides for the FDP has been far from costless -- it has often required leadership change within the party and has caused substantial turnover among party activists. While the FDP's pivotal position secured it a role in government, its previous commitments made

its political assets difficult to transfer, thus increasing the costs it faced for joining subsequent governments (Poguntke 1999). This kind of problem is known as one of asset specificity.

Asset specificity is the degree to which an asset's value depends on the continuation of a specific relationship. A politician's assets are specific when he invests time and prestige in pursuits that are difficult to transfer to other coalitions or portfolios. Asset specificity and walk-away values can be negatively correlated – particularly when a coalition is capable of terminating a member after it receives the value of that members' specialization.

Attention to how transaction costs affect bargaining also directs us to the fact that coalescence, by reducing uncertainty and curtailing opportunism, can produce **convergent expectations** about government's future actions among coalition partners. In complex situations, the value of convergent expectations cannot be underestimated. Coalition members who share the same beliefs about the consequences of their collective actions can act with greater confidence regarding other members' promises. As a result, they are better able to adopt a long-term perspective in a wider range of situations. As many important policies require government to maintain support for an extended period of time (as is often the case, for example, with economic reforms that involve painful transition periods), convergent expectations can give everyone involved a greater confidence that they will realize long-term benefits from short-term sacrifices.

Convergent expectations generate broader benefits as well. To see how, consider that many government objectives can be achieved only if bureaucrats or private citizens cooperate (i.e., the efficiency and legitimacy of a change in the tax code are helped if citizens do not defy the changes). For such policies to work, outside interests (including private citizens) must opt to "invest" in the government's plan of action. If outside interests do not share convergent expectations with the government, they may be reluctant to participate in activities that benefit the country. With coalition-instilled convergent expectations, it becomes less risky for private citizens to invest in publicly beneficial actions. Therefore, coalition agreements that counter uncertainty and opportunism can generate broad collective benefits.

This point also reinforces our earlier claims about the drawbacks of floating majorities. The promise of a stable coalition reduces the risk of specializing to any member because stable coalitions are better able to offer long-term rewards. If coalition partners are better able to specialize, the number of areas in which government has expertise will grow. Such investments in expertise allow government to adapt to a wider range of unforeseen contingencies, which, in turn, allow it to govern more effectively. With such knowledge in hand, our coalition governance theory is complete.

3. Electoral Connections, the Shadow of the Future and Termination

We now apply the theory developed above. We do so by focusing on a critical decision for any governing coalition – the decision to replace the government or dissolve parliament. In most parliamentary democracies, such decisions can be made on any given day. As Lupia and Strom (1995: 648) describe it, governments

"in parliamentary democracies lead a precarious existence. Typically, they can fall on any given day, and sometimes with little or no warning. The circumstances surrounding coalition termination vary greatly, occasionally producing great drama. Some politicians are forced from their cabinet offices in a daze, never knowing what hit them. Others choose their date of departure and leave with smirks on their faces."

In most parliamentary systems, election dates are not entirely fixed by a constitution, but subject to decisions by members of parliaments themselves. In countries where coalition governments are the norm, the timing of elections is the product of the kind of bargaining dynamics described above. In what follows, we apply our theory to explain why, when and how coalition governments choose to end their reigns. The application is a formal model of coalition decision-making (Lupia and Strom 1995) in which termination decisions are made via bargaining and where parties can factor voter reactions and the shadow of the future into their negotiations. We focus here on conveying the model's main substantive insights.

Lupia and Strom prove (1995, Theorem 1) that dissolutions require a set of parties that collectively have a parliamentary majority and, individually, each prefer new elections to continuing parliament as it is. Moreover, each party that has the ability to be part of such a majority must also prefer the anticipated

consequences of new elections to the most favorable and acceptable offer for a replacement cabinet that other parties can make (Lupia and Strøm 1995, Theorem 1).

This result, which comes from conceiving of coalition decisions as the product of bargaining, amends widely held beliefs about election timing. Grofman and van Roozendaal (1994: 158), for example, argue that "anticipation of future electoral gains may cause a certain party or a group of parties to seek to bring down the cabinet at a moment when their anticipated electoral success will be greatest," and hypothesize that "Parties terminate cabinets when they expect electoral gains". Accounting for the role of bargaining in coalition politics reveals this hypothesis as only partially correct. Indeed, **a party with favorable electoral prospects will also consider the option of extracting advantages through non-electoral means** (e.g., bargaining with parties that have less favorable electoral prospects.). A replacement cabinet, rather than new elections, is particularly likely if key members of the existing coalition have a strong desire to avoid elections. Therefore, **good electoral prospects for any particular party are not sufficient to cause a parliament's dissolution.**

The same logic (Lupia and Strøm 1995, Corollary 1) shows that dissolution is most likely when there exist parties in the coalition that: (a) expect large benefits from an election; (b) face small election-related transaction costs, (c) face large transaction costs for negotiating non-electoral transfers of power, (d) derive little value from the seats they currently control and (e) derive little value from the other coalitions they could enter.

The corollary is important as it suggests an interactive effect between time elapsed since the last election and whether a specific event (such as a war) will end a government or parliament. To see this effect, first note that most parliamentary democracies have constitutionally mandated limits on the maximum length of a parliament's term - the "constitutional interelection period" (King et.al. 1990). Before the time since the last election reaches, calling new elections is merely an option. When this limit is reached, elections must be held.

If early elections mean that parties sacrifice greater policy-making opportunities and benefit-collection opportunities than later elections do, and all else constant, then as the parliamentary term approaches its limit, the benefits parties can expect from holding new elections should decrease. That is, all else constant, the value of sustaining the current coalition should be relatively high early in a parliament's term, should decrease continually over that term, and should reach its minimum when parties have no other choice but to hold an election. Parties must forfeit currently held assets when an election is held. To the extent that a party derives value from being part of a coalition or parliament, the fact that such assets may be lost after an election means that, all else constant, **a coalition's value to its members should decay as a parliament ages - converging to zero when there is no choice but to hold an election.** Hence (following the corollary), an event that does not cause dissolution early in a parliament's term could do so later.

In general, **focusing on coalition decision making as a process of bargaining that occurs in the shadow of public opinion reveals that the extent to which an event is "critical" depends on the bargaining environment.** For instance, if the transaction costs of having an early election are high, then dissolution requires a large event. Thus, if these costs decrease over time, then dissolution requires smaller events as a parliament ages.

Such conclusions run counter to the assumption of a constant hazard rate in early models of cabinet stability (Browne, et.al. 1986; Cioffi-Revilla 1984). Warwick and Easton (1992) and Kaashoek (1993) have questioned this assumption in the past, showing little empirical support. By contrast, Warwick (1992) finds impressive cross-national evidence that the hazard rate for executive coalitions increases over time. This is consistent with what our model predicts (i.e., the corollary stated above). Since the original publication of our result, scholars have our approach as the basis for more effective empirical analyses of coalition termination (e.g., Diermeier and Stevenson 1999.)

Similar logic affects several widely held claims about coalitions. For example, formal theories of coalition formation in a three-party legislature predict that the governing coalition will comprise the largest and smallest legislative parties (e.g., Austen-Smith and Banks 1988 and Baron 1991). Our approach reveals

that these predictions are not robust to the introduction of parties who look forward to the next coalition termination or election when they bargain. To see why, notice that a necessary condition for the "largest-smallest" prediction is that the party to whom an acceptable offer is made must control either the smallest or the largest number of seats. Now consider the general case in which the largest party, i , is in the position to make an offer. All else constant, the offering party should prefer to coalesce with the more valuable coalition partner (assuming that there is a difference). If all else is not constant, however, then the offering party must consider the trade-off between the value of a coalition partner and the share of portfolios and other benefits that it can retain. If the larger potential coalition partner has a lower walk-away value than the smaller one (e.g., if the former is a virtual pariah) and is willing to make a better deal, then the offering party could choose to coalesce with the larger party.

If an offer is made, then it will be made to the party whose walk-away value is lowest. Such behavior **does not require the largest and smallest parties to coalesce**. Instead, **an offer is made to the weakest party**, where the weakest party is the one that faces the most walk-away value-damaging combination of (1) bad electoral prospects, (2) high election-related transaction costs, (3) high bargaining costs or discount rates, (4) low-value coalition alternatives, and, (5) highly valued seats or coalition-related power (that must be forfeited as a result of coalition termination or parliamentary dissolution).

4. Conclusion

In this chapter, we offer and apply a theory of coalition politics. Its main premise is that *coalition decisions are the result of bargaining in the shadow of citizen opinions and the constant threat posed by the potential coalitions that can replace them*. It illuminates how factors such as walk-away values, institutions, discount rates, and deadlines affect what coalitions do. It also clarifies how uncertainty and opportunism affect the content of coalition agreements.

This theory is a basis for the empirical work that you will see in subsequent chapters. These hypotheses describe important decisions such as coalition formation, policy making, and coalition termination. Throughout, these analyses correct the errors in beliefs such as "size is power," "length of

bargaining implies effectiveness of contract" and "external shocks cause coalition terminations" and replace them with hypotheses that are more consistent with bargaining dynamics.

We conclude this chapter by comparing our theory's insights to those of previous accounts. We hope that this comparison clarifies the benefits of conceiving of coalition governance as a context where the role of bargaining, electoral connections, and the shadow of the future are fundamental.

1. Country-specific factors are the whole story.

Those who engage in coalition politics are doubtlessly influenced by cultural or historical factors unique to their country. But regardless of the flag that flies outside their windows, every member of every governing coalition enjoys the benefits of governing only if they satisfy the two requirements of coalition participation – making and maintaining agreements with partners and pleasing voters. As a result, they must bargain with electoral connections and the shadow of the future in their thoughts. Once the centrality of bargaining is recognized, it follows that if a country-specific factor does not affect the walk-away value of at least one potential coalition member, then regardless of how important this factor is in other parts of public life, it will have no bearing on governance. Of course, we suspect that country-specific factors and walk-away values are often correlated and believe that careful empirical studies of the correspondence are a fruitful avenue for future research.

2. Resource distributions among political actors are not the whole story.

Resources, such as control over parliamentary seats, are clearly critical in the bargaining that precedes the making and breaking of coalitions. While having more resources rather less can be beneficial in bargaining, having more votes or money than others are less useful when your preferences are sufficiently different from those of potential coalition partners or if, for other reasons, your walk-away value is not commensurate with your assets. Indeed, a wealthy, but impatient, party can have a smaller walk-away value than a smaller, patient party.

3. Institutions are the whole story.

Institutions clearly matter, but their effects depend on other factors. While institutions affect how walk-away values are translated into coalition agreements and policy outcomes, non-institutional variations in walk-away values are also critical to explaining coalition behavior.

4. **Preferences determine coalition behavior.**

Preferences too are important in coalition bargaining, but they do not determine who gets what in isolation. Walk-away values, which can be a function of preferences, are of fundamental importance. If, for example, a party strongly favors a particular policy position, but lacks bargaining leverage because its walk-away value is zero (e.g., its supporters will not allow it to enter into other arrangements), then it may be ignored when coalition agreements are finally made. Moreover, the idea that common interests imply happy and successful coalition partners is a seductive one. After all, why shouldn't people with common interests pair up? The flaw in this view comes from ignoring the costs of bargaining, particularly transactions costs. Even parties that are ideologically proximate may need assurances about an uncertain future. If these assurances are sufficiently costly (e.g., if they require a restrictive coalition agreement), then potential coalition partners may seek other coalition possibilities.

In short, a coalition's ability to accomplish anything requires that it come to an agreement. Some policies, such as those required for economic and social development, require longer government commitments if they are to be successful. Transaction cost economics reminds us that accomplishing such objectives requires the ability to overcome problems caused by opportunism and uncertainty over long periods of time. Coalitions must be able to write agreements that protect these policies -- giving coalition partners incentives to choose to stick with the agreement rather than making or accepting an offer to join a new governing coalition that is unfriendly to the current government's policy commitments. In other words, coalitions who recognize the centrality of bargaining, electoral connections, and the shadow of the future are far more likely to succeed politically than parties who focus exclusively on any of the four factors named above.

An analogous way of stating this conclusion is that coalitions that expect to survive over longer periods can accept more risk and expect higher returns from long-run policy commitments. They expect higher returns even if a particular policy agenda can lead to bad outcomes in the short run because their coalition planning makes them more likely to survive until the return of happy days. Coalitions that expect to survive will therefore have a greater legislative range -- an ability to undertake agendas that more vulnerable coalitions cannot touch.

While coalition governments vary in ways that often seem inscrutable, it is imperative that the dynamics of coalition governance be as transparent as possible. The point of this chapter is to increase the extent of transparency. Since party coalitions dominate parliamentary democracies, which in turn rule about one-third of the world's population, the potential payoff from greater transparency makes this book's collective research pursuit worthwhile.

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