

# Democracy as an Arbitration Mechanism.

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## Abstract

We analyze a dynamic game played by two parties involved in a violent conflict, who decide (1) to sign a peace agreement and (2) join forces to create a new government and distribute the political offices of this government among themselves. However, because each party has an incentive to grab all political offices for itself, the parties agree to give the right to an arbitrator to appoint members of the two factions to the political offices. We show that among the available arbitration mechanisms, popular arbitration or democracy is the most likely to generate elite cooperation and effective government. We use our framework to develop a theory of democracy as a self-enforcing arbitration mechanism for elite power-sharing contracts. We illustrate the analysis with case studies from Lebanon, El Salvador and Francophone Africa.

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## I. INTRODUCTION

The purpose of this paper is to explore the emergence of democracy in countries with weak civil societies. By democracy we mean a political system in which (1) political power is allocated by means of competitive elections, (2) both the losing party and the winning party abide by the electoral outcomes (3) the people benefit from participating to the electoral process. We study political situations in which rival political groups are competing for power and want to settle an ongoing political conflict by designing a power-sharing contract as well as selecting an arbitrator for such a contract. We assume that they can select either an external arbitrator such as a foreign power or an internal arbitrator such as the citizens of the country. We show that the choice between these two arbitration mechanisms involves a trade-off between enforceability and neutrality: Popular arbitration of an elite power-sharing contract is superior to external arbitration because the action of the people (electoral outcome) is more likely to be perceived as *fair and neutral* by the political parties and is less likely to be subject to *ex post* renegotiation.<sup>1</sup> However, popular arbitration is inferior to external arbitration because, in contrast to an external arbitrator, the people may lack the power to *enforce* their own decisions. In other words, when civil society is weak, as it is the case in this paper, voters cannot stop either party from altering electoral outcomes.<sup>2</sup> We conclude that when parties are disarmed and electoral outcomes cannot be altered by a party, popular arbitration or democracy can generate elite cooperation and effective government.

The fact that democracy emerges in nations with weak civil societies has led many authors to downplay the importance of civic culture in transitions to democracy and to emphasize elite bargaining (Przeworski, 1991, O'Donnell and Schmitter, 1986, Diamond and Linz, 1988)<sup>3</sup>. For instance, O'Donnell and Schmitter (1986) claim that transition to democracy is often the outcome of a division within the authoritarian regime between hard-liners or radicals on the one hand and soft-liners or moderates on the other (p. 15-16). Rustow (1970) hypothesizes that democratization is set off by a prolonged and inconclusive political struggle followed by a deliberate decision on the part of political leaders to accept the existence of diversity in unity and, to that end, to institutionalize crucial aspects of democratic procedures (p. 355). Neither Rustow nor O'Donnell and Schmitter, however, present a theory of why political forces involved in an inconclusive conflict would settle precisely on democracy and

not on other forms of power-sharing. So, why do political groups in conflict ever settle on democracy? Przeworski (1996) addresses this question, first by defining democracy as an incomplete power-sharing contract with the ultimate or residual power changing hands with positive probability. This is contrasted with dictatorship where this residual power never changes hands. Przeworski then argues that a dictatorial contract is not an attractive option for political groups in conflict because it would give one group a decisive advantage in the event of an open conflict.

Przeworski's argument is a helpful point of departure, but has at least two limitations. First, it does not explain the choice of democracy in a situation where there is a strong and non-partisan state in which the probability of future violence is extremely low. In our view, Przeworski's argument is essentially a justification for limited government or a non-partisan state, not a justification for democracy. For instance, if the state is weak, even a temporary or a randomly chosen dictator can choose to attack the opposition party immediately after the election. Second, Przeworski's argument neglects the crucial issue of contract enforcement. While in an economic environment it is reasonable to assume that there is a court acting as the ultimate arbitrator, there is no obvious analogue of an external arbitrator of agreements among political elites. The way out of this problem is often to delegate some power to a third party that acts as the ultimate arbitrator and enforcer. But this delegation of authority may jeopardize the contract and the cooperation may fail to materialize. This may happen if, for example, the arbitrator is suspected by one of the parties to be biased towards the other party. In the present paper we derive a rationale for democracy even when the likelihood of future violence is arbitrarily low and we *explicitly* analyze the third party arbitrator's incentives.

Consider the possibility that a foreign power or the clergy arbitrates and enforces power-sharing arrangements between rival political groups. Indeed, after World War II, political systems in many developing countries were based on explicit or implicit elite political arrangements implemented by a foreign power. During the Cold War, the Soviet Union was the enforcer and the ultimate arbitrator of political arrangements in Eastern Europe while the French and the U.S. governments played similar roles in Francophone Africa and Central America, respectively (Foccart, 1994). In Lebanon, following the 1990 Taif agreement the Syrian government became the official arbitrator and enforcer of political order in the country.

This raises the following questions: (1) under what conditions will political elites choose external arbitration of power-sharing agreements, and (2) will the elites ever cooperate by creating an effective government under external arbitration? In other words, in the event that parties settle on external arbitration, will they spend enough time and energy to make the government work? We show that even when the external arbitrator is clearly known to be neutral, as long as long it has some military power, it *cannot* commit against using this power to initiate and enforce side-agreements that would establish a one party rule. Since such agreements clearly make one party worse off, this party will put in a low level of effort in government activities. Thus, unless an external arbitrator is imposed upon the parties, these considerations may lead them to prefer another type of arbitrator. We show that this arbitration role can be played by the citizenry, which explains why political elites will initiate democratic regimes.

We show that when the electorate is sufficiently diverse, the citizens *can* commit to be an unbiased arbitrator. Furthermore, in contrast with the external arbitrator the citizens can also commit against initiating side-agreements because they do not have the military power to enforce such agreements. Thus, the two key features of democracy as an arbitration mechanism that we want to stress are (1) the inability of a mass of voters to get together after the vote to undermine the result and (2) the fact that the citizens tend to have more moderate or neutral party preferences than a single external arbitrator.

Section II of the paper illustrates the key assumptions of the model and provides a series of examples that are consistent with our theoretical predictions. The following are some testable empirical implications of the model: (1) countries with a dominant political player acting as an arbitrator will tend to have ineffective governments, be less stable, and be more conducive to dictatorships, and (2) countries with no dominant player acting as an arbitrator and with a sufficiently diverse electorate are more likely to democratize than those with one dominant political actor and/or a dominant voting block. For instance, *ceteris paribus*, democracy will be more difficult to establish in countries such as Rwanda or Burundi with one dominant ethnic group and one dominated ethnic group mobilized by two ethnically based political parties. Furthermore, (3) democracy is likely to collapse if there is a shift in the preferences of the electorate from a unimodal to a bimodal distribution and one group of voters

gets very small.

Our substantive argument builds on the Shumpeterian model of democracy by assuming that the act of voting is also an act of arbitration of political conflicts between parties over the distribution of spoils of office. However, we consider an alternative arbitration mechanism: that involving one powerful player such as a foreign power, the armed forces or the clergy. Our formal model builds on the Downsian model of electoral competition and the arbitration model developed in Farber [1980]. As in the standard Downsian framework, we assume that parties care about winning and that voters have policy or party preferences.<sup>4</sup> But, in contrast to the Downsian framework, the present model endogenizes the value of the spoils of office as well as the electoral process itself. We assume that the spoils of office depend on the level of effort spent by parties in running the government and that the electoral process is one of many choices faced by the political parties when initiating political reforms. The model also builds on the external arbitration literature by assuming that the arbitrator has preferences over the distribution of the shares of spoils of office that go to one party or the other. In contrast to the standard model, the external arbitrator has an enforcement power. It has the resources to punish a party that tries to alter the arbitrator's allocative decision.

The paper is organized as follows: Section II presents the model. Section III discusses the equilibrium outcomes under external and popular arbitration. Section IV concludes, and all the proofs are in the appendix.

## II. A SIMPLE MODEL

Two parties that have been involved in a costly and inconclusive conflict consider the possibility of signing a peace agreement and creating a new government.<sup>5</sup> If they do not sign the agreement each party receives a reservation payoff which is the status quo value of the conflict. If the parties do sign a peace agreement, they join forces to create a new government and distribute the political offices of this government among themselves. However, because bargaining over future spoils of office is extremely costly, an *independent* third party is called upon to arbitrate the process of creation of the new government. The third party has the right to appoint members of the two factions to the political offices and to decide how the spoils of office will be distributed.<sup>6</sup> The third party or the arbitrator can be a single player (i.e. a foreign

power, the armed forces, or the clergy). It can also be a large set of individual players such as the citizenry of the country. We index the factions by  $i = L, R$  where  $L$  means left-wing party and  $R$  means right-wing party. We denote the single arbitrator by  $E_X$  and the large set of arbitrators or the people by  $E_P$ .

**Remark:** The present model is not of the type principal-agent. Instead, it is a model of partnership with external arbitration. In other words, the third party in our model is an independent arbitrator. She is neither an agent nor a principal.

### An Example

More concretely, consider the interaction between the Muslim party (or the coalition of Muslim parties) and the Christian party (or the coalition of Christian parties) in post-war Lebanon.<sup>7</sup> The two parties have to decide whether they should divide the country into two separate states or to create a new common government. If they decide to create the new government, they have to choose an arbitrator such as Syria or the citizens of Lebanon. Syria exemplifies an external arbitrator,  $E_X$  while the citizens of Lebanon exemplify a popular arbitrator  $E_P$ . If both parties announce Syria or the people of Lebanon as arbitrator, the arbitrator appoints members of the Muslim party and the Christian party to government positions. By making such a decision, the arbitrator is in fact announcing the distribution of the share of spoils that will go to either party.

After the arbitrator has made its allocative decisions, both parties invest their efforts and skills in running the new government of Lebanon. However,

once the investment is made and the new government is up and running, the arbitrator can choose whether to alter the original allocation of government resources. For instance, Syria can choose to oust the members of the Christian party from government. Also, the people of Lebanon, who are largely Muslim, can take to the streets after the election and force all non-Muslim officials out of government. The model will help address the following questions: why did Syrian dominance increase the power of the Sunnite Muslims and weaken the power of the Christians? Is Syrian dominance responsible for bad governance in Lebanon? What are the preconditions for a democratic Lebanon?<sup>8</sup>

The model is relevant not only to analyze the issue of Syrian dominance in Lebanese politics but also a discussion of the future of Kosovo. More precisely, the model could

address the following questions: what is the role of NATO, the United Nations and the citizens of Kosovo in the formation of an interim government and the establishment of democratic governance in Kosovo? Why did the Government of Yugoslavia insist on United Nations being the arbitrator of future political disputes in Kosovo while the KLA wanted NATO as the arbitrator? We address these questions by constructing a dynamic game with two parties  $L$  and  $R$  and an arbitrator  $E_X$  or  $E_P$ . The following table summarizes the main results.

**Table I: Summary of the Main Results.**

	<b>External Arbitrator (<math>E_X</math>)</b>	<b>The People (<math>E_P</math>)</b>
<b>Enforcement</b>	Strong	Weak
<b>Arbitration</b>	Collusive	Fair/Neutral
<b>Governance</b>	Mixed or Poor	Effective or Mixed
<b>Examples</b>	Syria (Lebanon), France (Gabon)	El Salvador, India.

### Preferences

Political parties in the model are Downsian in the sense that they derive their utility from the spoils of office. However, our model differs from the standard Downsian model in two ways: First, contrary to the standard Downsian assumption on party motivation, the total value of the spoils of office in our model is not exogenously given. It can be either high or low depending on the level of effort and resources that parties choose to invest in government activities.<sup>9</sup> We denote by  $\theta_i$ , party  $i$ 's endowment in these resources or the stock of knowledge and expertise that members of party  $i$  have in running governmental affairs. Second, we depart from the standard Downsian model by making the electoral process itself endogenous. More precisely, we consider the electoral process as one of several arbitration mechanisms that the parties can choose to settle disputes over the distribution of the spoils of office.

The arbitrator has preferences over its share of spoils and over the distribution of the spoils between the parties, i.e. party preferences. That is to say, Syria has preferences as to the overall level of the government resources in Lebanon and would rather have more than fewer of these resources for itself. In addition, we assume that Syria has party preferences: it can favor the Muslim or the Christian party, or

be neutral. We define the party preference parameter of the external arbitrator by  $s^*$  where  $s^* \in [0, 1]$ .<sup>10</sup> For instance one type of arbitrator might be characterized by  $s^* = 1$  and would want all the political offices or the spoils of office to go to  $R$ , while another type might be characterized by  $s^* = 0$  and want all the political offices or the spoils to go to  $L$ . We assume that preferences over the distribution of political offices are derived from some basic policy preferences. An arbitrator with right wing policy preferences will be characterized by  $s^*$  closer to 1 and an arbitrator with left-wing policy preferences will be characterized by an ideal point  $s^*$  closer to 0. For a moderate arbitrator, the party preference will be  $s^*$  closer to  $\frac{1}{2}$ .

When the arbitrator is the citizenry, voting outcomes determine the distribution of the spoils of office. The citizens vote sincerely according to policy preferences  $p^*$  such that  $p^* \in [-1, 1]$ . We motivate sincere voting by assuming as in Cox (1990) that voters know their own preferences but not those of others, and that costs for processing information about others' preferences in mass elections are prohibitive (p. 924). Sincere voting implies that there is a mapping between a voter's *policy* preference and his or her *party* preference. We define the party preference by  $v^*$  and assume for the sake of clarity that  $v^* = 1$  or  $v^* = 0$ . For a left wing voter  $p^* \in [-1, 0]$ , and  $v^* = 0$  and for a right wing voter  $p^* \in [0, 1]$  and  $v^* = 1$ . In other words, a right wing voter wants all the spoils of office to go to the right wing party  $R$  (that is,  $v^* = 1$ ) and a left wing voter wants all the spoils to go to the left wing  $L$  (that is,  $v^* = 0$ ). We assume that each voter knows his or her own policy preference but does not know the other voters' preferences. We define by  $F$  the distribution of  $p^*$  and by  $f$  its density.

### Investment and Allocation of Spoils of Office

We denote by  $x_i$  the investment, or effort, chosen by party  $i$ , define  $G(x)$  as the total amount of spoils of office generated by the effort vector  $x = (x_R, x_L)$  with  $x_i \in [0, \theta_i]$ . We define by  $c(x_i)$  the private cost of the effort level  $x_i$  chosen by party  $i$ .<sup>11</sup> We assume that it is worthwhile putting effort in government activities, that is, the incremental value generated by each party investing in the government is higher than the value created by retaining its resources. In addition, investment is necessary for the generation of spoils of office. Formally, we have

ASSUMPTION A1:  $\frac{\partial G(\cdot)}{\partial x_i} > c'(x_i) > 0$  for all  $x_{-i}$  and  $G(0, 0) = 0$ , and  $c_i(0) = 0$ .



From this assumption, it immediately follows that it is socially efficient to invest, i.e.  $G(x_R, x_L) > c(x_R) + c(x_L)$  for all  $x_R$  and  $x_L$ . In other words, the total level of spoils of office that the new government generates is higher than the total cost of generating them.

If the parties agree to create the new government and choose an arbitrator, they promise a share of the government's assets,  $a_0 \in [0, 1]$ , to the arbitrator.<sup>12</sup> However, as we mentioned earlier,  $a_0$  can be altered at the implementation stage, i.e. after the investment stage of the game. The share of the arbitrator is then  $a_1$  where  $a_1 = a_0$  if there is no alteration or  $a_1 = \bar{a}$  if there is alteration, with  $\bar{a} > a_0$ . The remaining share  $(1 - a_1)$  will be distributed to the parties by the arbitrator. We denote by  $\hat{s}_0$  the share of spoils of office that the arbitrator promises to the right wing party  $R$  before the investment stage and by  $\hat{s}_1$  the share that is actually given after the investment stage. In other words, at the appointment stage of the game, the arbitrator promises to the right wing party  $\hat{s}_0(1 - a_0)$  percentage share of the spoils of office and  $(1 - \hat{s}_0)(1 - a_0)$  to the left wing party. At the implementation/renegotiation stage, it gives  $\hat{s}_1(1 - a_1)$  to the right wing party and  $(1 - \hat{s}_1)(1 - a_1)$  to the left wing party.

If the arbitrator is the citizenry,  $\hat{s}_0$  is the outcome of an election involving a large set of citizen-voters.

Finally, we assume that citizens vote sincerely and there is no abstention. We also assume that government is based on proportional representation.<sup>13</sup> Before we discuss the renegotiation stage of the game, we summarize the timeline of the game.

## Table II: Timeline

1. Parties choose contract or no contract, choose  $E_X$  or  $E_P$  and promise  $a_0$  (by mutual agreement).
2. Arbitrator appoints, promises share  $\hat{s}_0$  and  $(1 - \hat{s}_0)$ . Government is created.
3. Parties choose effort  $x_i$ ,  $i = L, R$ . Spoils of office  $G(x)$  are realized.
4. Implementation/Renegotiation: arbitrator chooses  $\hat{s}_1 = \hat{s}_0$  or  $\hat{s}_1 \neq \hat{s}_0$ . One party chooses  $a_1 = a_0$  or  $a_1 \neq a_0$ .
5. Arbitrator enforces  $\{\hat{s}_1, (1 - \hat{s}_1), a_1\}$ .

## Renegotiation and Enforcement of Side-agreements.

At the renegotiation stage, the arbitrator can choose to stick to its promises or to propose a new (side) agreement to either  $R$  or  $L$ . For the sake of tractability, we focus on only one type of side-agreement: the one that gives either party sole control of government and gives the arbitrator a higher share of government resources. For example, if there is a side agreement with  $R$ , the arbitrator gives  $R$  sole control of government, that is  $\hat{s}_1 = 1$ , and the party gives the arbitrator a higher share of government output,  $\bar{a} > a_0$ .<sup>14</sup> The arbitrator can choose whether to punish the colluding partner if the latter fails to give  $\bar{a}$  to the arbitrator. More precisely, we will assume that there is a cost  $h$  to a party which reneges on the side agreement, and there is a strictly positive reputation cost for the arbitrator if it fails to punish a broken promise.<sup>15</sup> We denote by  $\rho \in \{N, Y\}$  the arbitrator's decision to punish or not punish a broken promise, by  $N$  the absence of punishment, and by  $Y$  the presence of punishment. The cost to the party is:

$$h(\rho) = \begin{cases} \infty & \text{if } \rho = Y, \text{ i.e. if it is punished} \\ 0 & \text{if } \rho = N, \text{ i.e. if it is not} \end{cases}$$

Our analysis depends on the difference in the assumptions we make about the two types of arbitrator. Here we make these assumptions explicit, and explain why they are plausible.

**ASSUMPTION A2:** The cost to the external arbitrator of enforcing the side agreement with party  $R$ , i.e. inflicting punishment on  $R$ , is  $C_{EX}(\rho, a_1, \hat{s}_1)$  with

$$C_{EX}(N, a_0, \hat{s}_1 > \hat{s}_0) > C_{EX}(Y, a_1, \hat{s}_1) > C_{EX}(N, a_1, \hat{s}_1 = \hat{s}_0) = 0.$$

where  $a_1 \in \{a_0, \bar{a}\}$ .

The cost of enforcing the side agreement with party  $L$  is analogous with  $(1 - \hat{s}_1)$  being substituted for  $\hat{s}_1$  and  $(1 - \hat{s}_0)$  for  $\hat{s}_0$ . The first inequality captures the fact that the enforcement cost is at the highest when the arbitrator fails to punish a party that reneges on the side agreement. That is,  $\rho = N$  despite the fact that  $a_1 = a_0$  (instead of  $a_1 = \bar{a}$  as promised) and  $\hat{s}_1 > \hat{s}_0$ . That is to say, this inequality captures the fact that the external arbitrator will suffer a loss of reputation or credibility if it lets a

violation of the side agreement by the party go by without punishment. The second inequality captures the fact that the decision to punish is always costly. Finally,  $C_{EX}(N, a_1, \hat{s}_1 = \hat{s}_0) = 0$  means that the enforcement cost is zero when the arbitrator does not change its original allocative decision and chooses not to punish.<sup>16</sup>

We now turn to the cost of punishment when the arbitrator is the people. We assume that an individual voter lacks the military power to initiate and enforce a side agreement with either political party. That is to say, contrary to Syria, a Muslim voter in Lebanon cannot force members of the Christian coalition out of the government in exchange of a higher share of the government resources. In addition, since civil society is relatively weak in Lebanon, we assume that the citizens of Lebanon as a whole also lack the military power to force the Christians out of the Lebanese government.<sup>17</sup> Define by  $C_{p^*}(\cdot)$  the cost to a voter of type  $p^*$  of enforcing a side-agreement with  $R$  and by  $C_{EP}(\cdot)$  the cost to the citizens as a whole, we have,

ASSUMPTION A3:  $C_{p^*}(\rho, a_1, \hat{s}_1) = C_{EP}(\rho, a_1, \hat{s}_1) = k$ , where  $k$  is very large.

Finally, we assume that neither the external nor the internal arbitrator has the ability to rule the country by itself. This means that it is very costly for the arbitrator to renege on the side agreement by taking more than  $\bar{a}$  of the government's resources. This assumption helps rule out the uninteresting situation where Syria completely takes over the Lebanon and excludes both Muslims and Christians from government, or the situation where France returns to strict colonial rule in Francophone Africa. It rules out the hypothetical situation where NATO would colonize Kosovo and exclude both the Albanians and the Serbs from the government. A share of at least  $(1 - \bar{a})$  of Kosovo's resources has to be in domestic hands for the Kosovo government to function. That is,  $C_E(\rho, a_1, \hat{s}_1)$  is very large for all  $a_1 \geq \bar{a}$ .

Even in the absence of side agreements, the arbitrator may have to prevent one party from grabbing the other party's share. More concretely, assuming  $R$  controls the government, the arbitrator may have to prevent  $L$  from waging a coup against the government. This case is very similar to side-agreement case discussed above. That is, (1) the party that does not abide by the arbitrator's decisions is punished, (2) such punishment is costly to the arbitrator itself and (3) the cost to the arbitrator is even higher if it fails to punish. As in Assumption A3, we assume that while these costs are not very high for the arbitrator, they are very prohibitive for an individual

voter and for the people as a whole. This leads to

CLAIM 1: Under external arbitration and in the absence of side-agreements, the decisions of the arbitrator stand. That is,  $\hat{s}_1 = \hat{s}_0$  and  $a_1 = a_0$ .

### Payoffs

Party  $R$ 's payoff has three parts: (1) its share of the spoils of office  $\hat{s}_1 [(1 - a_1) G(x)]$ , (2) the cost of exerting effort in investing in the new government  $c(x_i)$  and (3) the cost of the possible punishment due to reneging on the side agreement if such an agreement exists,  $h(\rho)$ . For instance, if parties choose to create a government and select an external arbitrator, and there is a side-agreement, the payoff for party  $R$  is:

$$u_R = (1 - a_1)\hat{s}_1 G(x) - c(x_R) - h(\rho)$$

If they choose to create a new government and there is no side agreement,  $i$ 's payoff is  $(1 - a_0)\hat{s}_1 G(x) - c(x_R)$ . If they choose not to create a new government,  $i$ 's payoff is 0. The payoff of  $L$  is analogous with  $1 - \hat{s}_1$  being substituted for  $\hat{s}_1$  and  $L$  for  $R$ .<sup>18</sup>

The utility function of the external arbitrator has three parts: (1) the spoils of office, (2) the negative of the distance between the distribution of spoils it chooses and its ideal distribution, and (3) the possible enforcement cost of the side agreement if such agreement were to take place and be violated. For instance, if the parties choose the external arbitrator, and  $E_X$  chooses to renegotiate in favor of either party, its payoff is:

$$u_{E_X} = a_1 G(x) - b(\hat{s}_1 - s^*)^2 - c_{E_X}(\rho, a_1, \hat{s}_1)$$

where  $b > 0$  measures the intensity of the arbitrator's ideological or party preferences. If they choose to create the new government and there is no side agreement, the payoff is  $u_{E_X} = a_0 G(x) - b(\hat{s}_0 - s^*)^2$ . When there is no new government, the external arbitrator's payoff is 0. We interpret  $a_1 G(x)$  as a measure of the economic interests of the arbitrator and  $b(\hat{s}_1 - s^*)^2$  as a measure of its ideological interests. We assume that economic interests override ideological interests if the arbitrator happens to be ideologically neutral.<sup>19</sup>

When the arbitrator is the citizenry, and there is renegotiation, the payoff for voter with policy preference parameter  $p^*$  and party preference  $v^*$  is:

$$u_{p^*} = a_1 G(x) - b(\hat{s}_1 - v^*)^2 - c_{p^*}(\rho, a_1, \hat{s}_1)$$

The payoff if there is no side agreement is  $a_0 G(x) - b(\hat{s}_1 - v^*)^2$  and 0 if there is no new government.<sup>20</sup> The way we have presented the payoff function of the people, the spoils of office they consume are a public good. Alternatively, we could have chosen that voter of type  $v^*$  receives a fraction of the spoils, and on aggregate the citizenry receives  $a_1 G(x)$ . This specification would require a slightly different interpretation but would not change any of the subsequent results. We conclude the presentation of the model with a summary of the main variables of the model.

Insert Table III here

Before we study the equilibrium outcome of the game, we present our definition of democracy. Following Downs (1956) and Shumpeter (1942) we define by democracy a political system in which (1) political power is allocated by means of elections (the people are the arbiter), (2) the losing party never tries by force or illegal means to prevent the winning party from taking office, (3) the party in power never attempts to restrict the political activities of any citizens or other parties as long as they make no attempt to overthrow the government in place, and (4) the people derives some benefits from being an arbitrator ( $u_{EP} > 0$ ).

DEFINITION 1: The new political system is democratic if (1) parties choose  $E_P$  over  $E_X$  as the arbitrator and (2) parties abide by electoral outcomes, that is  $\hat{s}_1 = \hat{s}_0$ , and (3)  $E_P$ 's equilibrium payoff is strictly positive.

The first part of our definition is Schumpeterian since we assume that rulers are selected by a device called elections. However, as in Przeworski (1991) we require that parties abide by electoral outcomes and that the people benefit from participating in the arbitration game.

### III. EQUILIBRIUM ANALYSIS

We now turn to the exploration of the equilibrium behavior of the players of this game. The questions are: will the players sign the agreement to create the new government? Even if the players reach such an agreement, will the political factions be ready to spend enough time and energy to make the government work? Will the arbitrator have an incentive to alter the original allocation of the spoils of office? We

rst show that the external arbitrator has an incentive to collude with one of the parties and this makes elite cooperation under external arbitration less likely.

### Equilibrium Under External Arbitration

**PROPOSITION 1:** Suppose parties choose an external arbitrator. Then under the stated assumptions, the external arbiter will collude with one of the parties at the expense of the other. In anticipation of this behavior, at least one party fails to invest in the new government.

**Proof.** Note that the first two elements of each set represent the parties' equilibrium strategies and the third element, the arbitrator's equilibrium strategies. We prove the first case here, since the argument is identical for the second case. After any sharing rule specified by the strategy  $\hat{s}_0$  of the arbitrator, there exists an incentive<sup>21</sup> for the arbitrator and party  $R$  to collude in the following sense: the external arbitrator can choose  $\hat{s}_1 = 1$  and party  $R$  can choose  $a_1 = \bar{a}$ ,  $\bar{a}$  appropriately chosen such that  $\bar{a} - a_0 < 1 - \hat{s}_0$ <sup>22</sup>. Here  $\hat{s}_0 = s^*$  since  $s^*$  is the external arbitrator's party preference parameter. This leaves both  $R$  and the external arbitrator weakly better off. The agreement is enforceable since, for reputation reasons, the arbitrator will punish deviations from the agreement by  $R$ , following assumption A2. This being the play in the last stage of the game, party  $L$  will do little in terms of government activities, since if it were to make an effort its expected returns would be zero. ■

Under external arbitration, at least one party fails to invest in government because it anticipates that the external arbitrator will behave strategically and give the other party sole control of government in exchange for a higher share  $a_1 = \bar{a}$ . However, as the following proposition shows, external arbitration could generate elite cooperation and effective government if the arbitrator could commit to a share  $\hat{s}_1 \in [\underline{s}, \bar{s}]$  where  $\bar{s} > \underline{s} > 0$ .

**PROPOSITION 2:** There exists a set  $\mathbf{S} = [\underline{s}, \bar{s}] \in (0, 1)$  such that if the shares of the parties lie in  $\mathbf{S}$ , then the parties invest fully in the government project, i.e.  $x_i = \theta_i$ .

**Proof.** The existence of the set  $\mathbf{S}$  derives from the fact that the total government product is larger than the corresponding values attainable by not investing, from

assumption A1 above. That is, assumption A1 implies that  $G(x_1, x_2) > \sum c(x_i)$  for all  $x_i, i = 1, 2$ . Thus, there exists a sharing rule  $s'$  such that both parties are better off under this sharing rule and investing than they would be if they were not investing. This proves that  $\mathbf{S}$  is non-empty. In addition, under this sharing rule it is optimal for both parties to invest all their resources in the government process, since they can earn a higher value. ■

Note that the arbitrator may become worse off because the size of the pie will be smaller than it would have been if the arbitrator could commit to a share in the set  $S = [\underline{s}, \bar{s}] \in (0, 1)$ . Proposition 1 shows that  $E_X$  is unable to commit to choose a share in the set  $S = [\underline{s}, \bar{s}] \in (0, 1)$  or to alter this allocation ex post. The arbitrator cannot commit to give such a share for the following reasons: (1) dictatorial side-agreements are an available option and lead to a higher payoff for the arbitrator, and (2) the arbitrator has the military power to enforce any allocative decisions that it makes.

Francophone Africa constitutes a textbook example of the pitfalls of a political system built on elite contracts implemented or arbitrated by a foreign power. Despite conceding independence to its former colonies in 1960, France retained the rights to enforce political order in these countries, with troops stationed in Gabon, the Ivory Coast and the Central African Republic. As Foccart (1985) has acknowledged, France used these rights to protect the power of the Friends of France among African elites. In exchange for this protection, the Friends of France helped maintain the relatively strong French economic and cultural influence in Africa. This collusion between some African elites and the French government as well as the resulting political turmoil (numerous coup d'etats, civil wars or government bankruptcies in Congo, Benin, Cameroon, Gabon, and Chad among others) are consistent with the theory developed in this paper. The same logic applies to Poland and Hungary with the Soviet arbitrator being on the side of the communists. It also applies to Lebanon where the Syria acted as the arbitrator and was on the side of the Muslim majority.

### Equilibrium Under Internal Arbitration

In this section, we show that introducing the citizenry as an arbitrator can lead to an outcome which is better for everyone. Because we assume sincere voting, the existence of a voting equilibrium can be proven using a straightforward Downsian argument. In particular, the equilibrium vote share of  $R$  is  $s_0^e = 1 - F(0)$ . Thus, if the

people's preferences are sufficiently heterogeneous, their action (electoral outcome) is perceived not only by the parties but also by the people themselves as a random variable. In other words, when they cast their ballots in an election, voters operate behind a veil of ignorance. This is due to the fact that each voter knows his or her own preferences but not the preferences of others. As a result, they can credibly commit to be fair and neutral arbitrators. The result holds even if only a small but sufficiently heterogeneous subset of the citizens have the right to vote. Proposition 3 presents conditions under which democracy will be the equilibrium outcome of the game. In order to focus our analysis on the feasibility of side agreements under the two types of arbitration mechanisms, we assume that either a non-partisan State (coercive institution) already exists or it is being created. For the sake of emphasis, we express this as

ASSUMPTION A4. When parties choose the people as an arbitrator, they also create a state (if necessary). The State enforces electoral outcomes.

PROPOSITION 3: Suppose A1-A4 holds. Suppose also that the electorate is sufficiently diverse so that the electoral outcome  $\widehat{s}_0^e$  lies in  $\mathbf{S}$ . Then parties choose the people as an arbitrator, and fully invest in government activities. When the vote share is not in  $\mathbf{S}$ , the choice of the populace as an arbitrator is still an equilibrium, but investment follows the rule is given by

$$a_0 \widehat{s}_0^e \frac{\partial G(x)}{\partial x_i} \leq c'(x_i), i = R, L.^{23} \quad (\text{C.1})$$

**Proof.** Having established propositions 1 and 2, the proof follows immediately by noting that popular arbitration can never be worse than external arbitration, and almost always is better. This is true because the probability of the vote share actually being zero is very small, and because there is no possibility for collusion on the part of the citizenry. To see the above claims, we note following: In the last stage of the game, as we have seen in proposition 1, external arbitration will be detrimental to the payoffs of some party. Thus, external arbitration will be opposed in the first stage by at least one party.<sup>24</sup> ■

The proof is driven by the fact that  $E_P$  is bound to choose a strategy from the interior of its strategy set and can commit to not altering this choice *ex post*. The assumption that voters only know their preferences is only used to justify sincere



voting and is not crucial to our result. The crucial assumptions are (1) the diversity of party-preferences among the citizens and (2) voters lack the military power to undermine electoral outcomes ex post. Unlike the external arbitrator, the citizenry can commit to not colluding with any party and its action is perceived as non-manipulable and exogenous. Under democracy, elected officials either keep their job until the next elections or they are removed from office under conditions clearly stipulated by the constitution. We argue that this temporary job security provides incentives for value-enhancing investments in government activities.

The proposition does *not* imply that popular arbitration or democracy is *always* better than external arbitrator and that elites will *always* choose democracy. Proposition 3 implies that democracy is better than external arbitration under the following two conditions: (1) there is a state capable of enforcing electoral outcomes (assumption A5) and (2) the preferences of the citizenry are sufficiently diverse. External arbitration may be better than democracy if the expected vote share of the key political parties is very small or if the state is weak and/or partisan. For instance the choice of an external arbitrator is an equilibrium if  $\hat{s}_0^e = 0$  or  $\hat{s}_0^e = 1$ , or if condition (C.1) holds for  $x_1 = x_2 = 0$ .

Proposition 3 helps explain why political elites in El Salvador settled on democracy in 1994 after 10 years of civil war which sunk the country into anarchy (Montgomery (1995)). During the course of this conflict which opposed government forces and the guerilla fighters of the Farabundo Martí National Liberation Front (FMLN), it appeared to both sides that an outright victory by either side was unlikely and that some form of settlement had to be reached. However, after peace negotiations started in 1989, the government and the military feared that the FMLN would use the peace process to build up its military strength and push for reductions in the size of the army, leaving the door open for rebels to seize power. On the other hand, the FMLN feared that the negotiations would expose the rebels' clandestine structure, enabling the military to gather intelligence on those involved and subsequently eliminate them in a massive 'dirty war'. As a pre-condition for democratic elections, the FMLN agreed to gradually demobilize its forces, and the government agreed to disband its three security forces (the National Guard, the National Police and the Treasury Police) and to establish a new National Civilian Police partly controlled by the FMLN. As Gibb-Smyth (1990) wrote: 'the stated goal of the parties was to create a political

system where real power is allocated by elections. The winners must be guaranteed that they will obtain genuine control over government decisions. The losers must be guaranteed that opportunities for their political participation would continue and would not subsequently be repressed and eliminated

Proposition 3 also applies to Francophone Africa where the wave of democratization started only after the Baule Summit in 1989, where the Mitterrand government switched from a policy of intervention to one of disengagement from African internal politics. This change in French foreign policy made the electoral process the unique mechanism for allocating power among the elites and led to a more cooperative behavior by African elites. Likewise, democratic change swept through Eastern Europe only after the collapse of the Soviet Union, the external power in charge of enforcing communist rule. The Soviet Union's breakdown created a new balance of forces between political groups that facilitated the emergence of democracy. The cases mentioned above serve to confirm our thesis: democratization can be understood as arising from the failure of an old model of external arbitration of elite political contracts and the increased attractiveness of the model of popular arbitration.<sup>25</sup>

#### IV. CONCLUDING REMARKS

The central argument of this paper, that democracy is essentially a self-enforcing mechanism for the fair and neutral supervision and arbitration of elite power-sharing agreements, has profound implications for our understanding of how democracy emerges and endures. Democracy literally means power of the people. However, as Sartori (1965) suggests, this expression is, at best, elliptical. Our paper provides a precise account of the populace's role in the most familiar forms of democratic regime, and suggests that we should take a different view of the meaning of democracy. We argue that, much of the time, democracy is best understood as a contract that essentially allocates power fairly among political elites with the people acting as the arbitrator of the process. The power of the people can then be seen as a gift by political elites to the people as a reward for its role as an arbitrator of their power-sharing agreement. Political elites choose to go to the people because (1) other potential enforcers have either been biased and therefore discredited or are expected to be biased, (2) the electorate can more easily commit to fair and impartial, or (3) electoral outcomes are less likely to be subject to *ex post* renegotiation.

The power that political elites concede to the people provides the electorate with the resources necessary for a successful arbitration of the agreement. It is in the elites' best interest to give away these resources; otherwise the new political system would not be created and fighting would continue. Thus, quite often in a democracy, it is not the people who delegate their power to political elites. On the contrary, it is political elites who concede some of their power to the people in order to secure the creation and the maintenance of the new political system.

The theoretical argument of the paper implies that long term foreign interference in domestic politics cannot be conducive to elite cooperation and democracy. However, short term foreign intervention sponsored by a multinational political institution such as the United Nations could generate elite cooperation. This is because the United Nations' actions tend to be strictly regulated and monitored and they are widely perceived as a more impartial arbitrator than say, the United States, France or Russia.

## ENDNOTES

1. By definition, democracy precludes the *ex post* renegotiation or alteration of electoral outcomes in forms of coup d'etats, exclusion of the opposition, or unilateral manipulation of the timing of elections. Downs (1956) wrote: "a government is democratic if it exists in a society where the following conditions prevail: 1) a single party (or coalition of parties) is chosen by popular elections to run the government apparatus, 2) such elections are held within periodic intervals and the duration of which cannot be altered by the party in power acting alone, [...] 6) the losing parties in an election never try by force or any illegal means to prevent the winning party (or parties) from taking office, 7) the party in power never attempts to restrict the political activities of any citizens or other parties as long as they make no attempt to overthrow the government in place" (p. 23).
2. Voters may leave unpunished a losing party that wages a coup against the party controlling the government or a winning party that deprives the opposition party of its political rights.
3. As Linz and Diamond write: "In Latin America, the choice of democracy by

political elites clearly preceded the presence of democratic values among the general public (Diamond et al [1989] p.12). This contrast with Weingast [1997] who argues that citizens' democratic values and elite interests are complementary aspects of democratization, and that the study of democratic civic culture is necessary to understand political elites' strategies during the process of democratization.

4. Downs wrote: "Politicians in our model never seek office as a means of carrying out particular policies; their goal is to reap the rewards of holding office *per se*." (p. 28). In Austen-Smith and Banks (1988) parties care about both spoils of office (a fixed amount of transferable benefits across the parties) and about policies.
5. Note that we use the word party to mean faction, not "political party" in the sense of the term meaning groups that run candidates under its label for elective office. Also, note that by costly political conflict, we are referring to any destructive competition for power.
6. We use the term "appoint" to mean "strongly influence the appointment of." Syria for instance does not always formally appoint members of Lebanese parties to government positions. However, following the May 1991 Treaty of Brotherhood, Cooperation and Coordination, Syria had had a strong influence on the formation of the Government of National Unity created in 1992. Syria approved appointees to the newly expanded parliament and pro-Syrian aspirants were named to key positions in the army and Syria made the final decision on all key political and diplomatic appointments (Mc Laurin, 1992). The 1998 presidential elections provide additional evidence for the Syrian dominance in Lebanese politics. Two weeks before the election, General Lahoud was *chosen* by Syrian president Hafez El Assad as the next president. *The Economist* wrote: "In the topsy-turvy world of Lebanese politics, declaring your candidacy is tantamount to admitting defeat, since a serious contender would wait for the Syrian nod before entering the fray." ("Assad's Choice," October 10, 1998, pp. 44-49).
7. There are roughly 25 parties in Lebanon and they have traditionally been reli-

gious (Christian, Sunnite Muslim, Shiite Muslim). The most prominent Christian parties are the *Phalangist Party* of Georges Saade and the *National Liberal Party* of Kazeem Khalil. The most prominent Muslim parties are *Progressive Socialist Party* of Walid Jumblatt and the *Syrian Nationalist Party* of Dawoud Baz. (See Banks and Miller (1998)).

8. For an empirical discussion of these questions, see Norton (1990).
9. Assuming that government is more effective when parties work harder, the endogenization of the value of spoils will allow us to investigate how the nature of the arbitration mechanism affects the effectiveness of the government. As Hamilton wrote in *The Federalist Papers*: Energy ...is the leading character of good government (p. 423).
10. We could assume that the external arbitrator preference parameter is private information. But this assumption will unnecessarily complicate the analysis.
11. It is the measure of the pain endured by the members of the Muslim party in working for the government of Lebanon, or a measure of what those members would have gained had they chosen to spend their skills in private activities instead of government activities.
12. This share could be seen in Lebanon where the government authorized Syria to station about 25,000 soldiers on a portion of Lebanese territory. In addition, Syria has a complete political control over the armed forces, the intelligence and the security forces (Norton, 1997). The share could also be seen in Gabon where France is granted part ownership of the country oil resources. (Yates, 1996). Also, note that to keep things simple here, we just use a high and low level of share to the arbitrator, a fact which does not compromise in any way the generality of the results.
13. Proportional representation is not necessary in our model. All we need is a strong (and presumably positive) covariation between the vote share and the allocation of spoils of office between the two parties.
14. The following is an example of such a side agreement: in the aftermath of the May 1991 Treaty of Brotherhood, Cooperation and Coordination between

Syria and Lebanon. Syrian control over the Lebanese government grew stronger and Muslim (especially Sunnite) presence in government also grew stronger (Norton, 1997). Such a side agreement could also be seen in Czechoslovakia in 1948 where Soviet Union masterminded the communist coup to oust non-communists from government. It may also be seen in Cameroon where the French government collaborated in wiping out the nationalist opposition to the ruling party led by Ahmadou Ahidjo. Foccart (1994) acknowledged that French secret service assassinated Felix Moumie, the leader of the Union des Populations du Cameroun. Also, note that from a modelling perspective, it is the arbiter who generates and enforces a side agreement. But this can be interpreted as if there were an agreement between the party and the arbiter, since the party gets a higher share in exchange.

15. This means that Syria would punish its allies in the Lebanese government if they try to renege on its agreement to grant Syria a more complete control of the Lebanese military. This also means that the Kremlin would heavily punish the Czech communist leaders if they renege on the terms of Warsaw pact.
16. We could expand the strategy set of either party to include self-defense when there is a side-agreement and the party which is excluded from government chooses to resist. This would lead us to also add repression or not repression to arbitrator's strategy set. Such an extension, however, would add nothing to the paper's main points.
17. Note that the inability to enforce side agreement is *not* due to collective actions problems but to *conflict of interests* in the electorate. For instance, while Christian voters in Lebanon may want Muslim officials out of the Lebanese government, Muslim voters would rather have those officials stay in government.
18. As the reader can see, the parties payoffs are Downsian. We simply subtract from the spoils of office (1) the cost of the effort that a party exerts in running government affairs and (2) a colluding party's cost for disobeying the arbitrator if this party chooses to do so.
19. That is,  $\forall x \neq (0, 0), \hat{s}_0 \in [0, 1], \hat{s}_1 \in [0, 1]$  ,  

$$(\bar{a} - a_0) G(x) \geq b \left| (\hat{s}_1 - s^*)^2 - (\hat{s}_0 - s^*)^2 \right|$$

20. Note that the arbitrator/voter's payoff is Downsian. However, the payoff also includes the share of government resources that the arbitrator/voter enjoys and the enforcement cost of a side agreement if such agreement exists.
21. We allow here for weak incentives.
22. The last inequality is derived from the fact the side-agreement has to be incentive compatible for  $R$ . We have  $(1 - \bar{a})G(x) - c(x_R) > \hat{s}_0(1 - a_0)G(x) - c(x_R)$  for all  $x, x_R$ , which implies that  $\bar{a} - a_0 < 1 - \hat{s}_0$ .
23. We assume that the functions are sufficiently well behaved so that a global maximizer exists, is unique, and is identical to the local maximizer for all  $x_i \in [0, \theta_i]$ . The inequality condition (C.1) takes care of corner solutions.
24. Here the political preferences of the external arbitrator, which we assume are known, come into play. Since the renegotiation game is a zero sum game from the perspective of the parties, the result that at least one party will oppose external arbitration is immediate.
25. The present model also captures an idea developed in Bardhan (1988) on the determinants of the stability of Indian democracy. Bardhan argued that the stability of Indian democracy is not due to liberal values in civil society, but to the fact that democracy provides an impersonal power-sharing rule for a highly divided elite, where no individual section of the elite was powerful enough to completely control the state.

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## APPENDIX

**Table III: Meaning of the Main Variables**

$R$	: Right wing party
$L$	: Left wing party
$E_P$	: The people, the electorate
$E_X$	: The external arbitrator.
$\theta_i$	: Party $i$ 's endowment
$x_i$	: Effort level chosen by $i$ .
$G(\cdot)$	: Government resources, spoils of office
$c(\cdot)$	: Cost of effort
$a_0$	: The arbitrator's announced share of government resources
$a_1$	: The arbitrator's realized share of government resources
$\bar{a}$	: The arbitrator's maximum share
$\hat{s}_0$	: $R$ 's announced share of spoils of office.
$\hat{s}_1$	: $R$ 's realized share of spoils of office.
$s^*$	: $E_X$ 's party preference.
$v^*$	: A voter's party preference parameter
$p^*$	: A voter's policy preference parameter
$F$	: Probability distribution over $p^*$
$f$	: Density of $p^*$ .
$\bar{s}$	: Maximum share for cooperation to be sustained
$\underline{s}$	: Minimum share for cooperation to be sustained
$C(\cdot)$	: Enforcement cost of the arbitrator.
$\rho$	: Enforcer's decision to punish deviation
$h(\cdot)$	: Cost of being punished