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CIVIL CONFLICT, FEDERALISM AND STRATEGIC DELEGATION OF LEADERSHIP.

BY

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Civil Conflict, Federalism and

Strategic Delegation of Leadership[*]

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Abstract
This article analyses negative externalities that policy makers in one region or group may impose upon the citizens of neighboring regions or groups. These externalities may be material, but they may also be psychological (in the form of envy). The latter form of externality may arise from the production of 'conspicuous' public goods. As a result, decentralized provision of conspicuous public goods may be too high. Potentially, a centralized legislature may internalize negative externalities. However, in a model with strategic delegation we argue that the median voter in each jurisdiction may anticipate a reduction in local public goods supply and delegates to a policymaker who cares more for public goods than she does herself. This last effect mitigates the expected benefits of policy centralization. The authors' theory is then applied to the setting of civil conflict, where they discuss electoral outcomes in Northern Ireland and Yugoslavia before and after significant institutional changes which affected the degree of centralization. These case studies provide support for the authors' theoretical predictions.

1   Introduction

In this article we focus on policy-making in an environment where a policy in one group imposes negative externalities on the members of another group. These externalities may be material (in the conventional manner), but the novelty of this article is that we extend externalities to include psychological ones that can be generated by conspicuous policies. Psychological externalities may have distinct effects. First, policies that favor some groups may provoke feelings of jealousy in others. Second, policies that favor some groups, for example by raising the consumption of public goods, may induce the 'keeping up with the Joneses' (KUJ) effect in other groups, as it raises the marginal utility of public goods consumption. We specifically focus our attention on the role of group identity as a trigger for jealousy and KUJ between groups that are engaged in conflict with each other.

In the theoretical part of the article we develop a two stage model where we introduce two opposing groups. We argue that rivalrous feelings affect leadership selection in each group in the first stage and policy outcomes in the second stage. To get a rough idea of the argument, with decentralized policy-making group members select a moderate leader so as to not aggrieve members of the other group. However, when groups cooperate, for example in a post-conflict institutional setting, they select extremist leaders who counteract the internalization of jealous feelings and material externalities. Hence, cooperation between groups in post-conflict societies may disappoint, as it triggers delegation to more hawkish leaders.

The logic of our model follows the median voter theorem where the median member in each group strategically selects a leader, as in Besley & Coate (2003). In contrast to other papers on the political economics of group conflict discussed below, we depict the median group member as the principal and the group leader as the agent. In a setting of two opposing groups where the leader effectively decides group activity in a civil conflict, we feel that this is a useful and logical extension of the existing theoretical literature. However, the focus on the optimal choice of the median voter in each group could be viewed as overly restrictive.

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The focus on within group choice rules out the possibility of an unaffiliated party emerging that appeals across both constituencies and steals the middle ground. While this may be a strong possibility in class-based politics where a centrist party may break down class divisions, it is much less valid for societies where voting is primarily based on religion or ethnicity. Thus, we focus our attention on elections in Northern Ireland and the republics of the former Yugoslav federation. To that end, we argue that decentralized policy-making increases the vote share of more cooperative parties, while centralized policy-making favors extremists and nationalist parties.

2   Related Literature

The psychological externalities that provide the main motivation for this article have given rise to an economics literature on the 'keeping up with the Joneses' (KUJ) effect of private goods. The notion that individuals value their consumption of private goods relative to others is the focus of the well-known book by Frank (1985) and applications have emerged in the finance literature (Abel, 1990; Gali, 1994; Campbell & Cochrane, 1999). In the latter, relative consumption of snob goods serves to explain the equity premium puzzle by showing that persons take too high gambles in the financial markets. It is easy to envisage yuppies gambling on dot-com stocks to finance a newer BMW than their peers. Chang & Kogan (2002) allow for heterogeneous consumption preferences for stock market gambles. Dupor & Liu (2003) argue that, with regard to consumption externalities, 'keeping up with Joneses' should be distinguished from jealousy. The first effect occurs when consumption by others raises an individual's own marginal utility from the consumption of certain types of goods. Jealousy implies that humans simply envy other people's consumption.

If individuals could commit to lower spending on conspicuous consumption goods, this would increase social welfare. However, for individual consumption it is hard to see how, in the absence of government intervention, this may come about. In any case, if citizens could draw up a contract, they would restrain themselves and each other from spending

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too much on conspicuous goods by regulation or progressive taxation, as in Lommerud (1989) and Konrad & Lommerud (1993). Clearly, there is a role for government to provide such a binding contract if the KUJ effect results in too high a level of conspicuous private goods consumption.[1]

KUJ relates to the effect of status competition at the level of individual psychology. We wish to extend KUJ to the level of social psychology. Within the social psychology literature, the most relevant theory for our purposes is 'social identity theory' associated with Tajfel (1981). Brown (2000, chapter 8) provides a detailed survey of work in this area, highlighting its core aspects and major themes. In particular, it has three main aspects, a cognitive aspect (awareness of group membership), an evaluative aspect (an ability to assess how well the group is doing) and an emotional aspect (feeling of attachment). With these three aspects in place, the performance of the group will affect the utility of group members. This performance is judged relative to that of other groups and a major theme of social identity theory is that contests can emerge where no obvious conflict of interest applies and that group members often engage in a 'maximizing difference strategy' which means that doing better than the other group is often chosen as the goal of group members even at some material expense. Social identity theory lifts KUJ to the level of collectives and just as KUJ leads to an overinvestment in conspicuous private goods, social identity may lead to overinvestment in conspicuous public goods.

In our case, where we analyze conspicuous public goods, a commitment device in the form of the preferences of the policy maker is at hand. Voters may strategically select a leader who has preferences different from that of their own so as to bind their own hands. This mechanism of strategic delegation of policy-making has been well known since Rogoff's conservative central banker (Rogoff 1985). Strategic delegation in an election setting was analyzed in Besley & Coate (1997). In Besley & Coate (2003) these authors show that strategic delegation of policy-

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[1] This may already have been foreseen in the Bible by making the Sunday a mandatory work-free day, possibly to restrain individuals from working too hard to keep up appearances (Dupor & Liu, 2003).

making authority in a centralized setting may result in perverse policy outcomes. The reason is that the median voter may delegate bargaining authority to a leader who cares more for public goods than she does herself. By doing so, the median voter commits to obtaining a higher share of the centralized funds that are spent on public goods. Dur & Roelfsema (2005) extend this analysis to allow for non-shareable cost in public goods provision. They argue that this may lead to the delegation of 'conservatives' to the centralized decision making body so as to avoid these costs, while at the same time benefitting from positive spill over effects of public goods produced in other jurisdictions.

Our theory requires us to consider situations where group pride exists, that it is a significantly salient political issue and that there has been a shift from decentralized to centralized decision-making. While national pride is still very much alive and politically relevant in areas such as investments in science and technology, sport and the military (see Evans & Kelley, 2002), the scenario that fits our theory best are conflictual societies where group identity is *the* political issue and there have been movements between decentralized and centralized decision-making. We focus on Northern Ireland and the republics of the former Yugoslav federation as obvious candidates for analysis. The article, therefore, fits with recent papers in economics which take the issue of identity more seriously as a factor in decision-making (for example Akerlof & Kranton 2000 and Glaeser 2005).

In various ways, our article is related to the recent literature on the economic incentives for civil conflict.[1] Collier and Hoeffler (1998, 2004) find that greed – for example capturing natural resources – is a significant cause of civil conflict. However, they tend to agree with Weinstein (2005) that rebellion is initiated by ideological leaders who act out of grievance with other groups, but that groups eventually end up with opportunistic leaders that act from greed. The theoretical explanation offered in our article for the latter phenomenon is that Weinstein's law of Gresham –

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[1] There is also a large literature that studies and finds support for the thesis that ethnic and religious polarization explains civil conflict (see, for example, Reynal-Querol, 2002)

bad leaders crowd out good leaders – results from the political acceptance of rebel forces by the political elite. When the elite tries to share power with rebel groups, this provides incentives for the members of the rebel group to support a different, more opportunistic leader.

The principal-agent set up used in this article reverses the order of events in group conflict analyzed in the literature so far. Following the seminal article by Grossman (1991), principals in the civil conflict are preexisting leaders who select group members as agents. For example, as in our model, Azam (2002) builds a game-theoretic framework where the leader decides on the group activity in civil conflict. However, he does not address the origin of the preferences of the leader of group activity. Gates (2002) endogenizes group membership by looking at the microfoundations for why people join rebel forces and how leadership may prevent members from exiting. The contribution of our article is that we endogenize leadership selection in groups, so we add political economics to the conflict literature by treating leaders as elected officials who then conduct group activity.[2] As members of a group are forward looking, they anticipate the consequences of leadership selection.

3   Assumptions

Consider two groups of equal size indexed by $i = 1, 2$. Each member in group 1 contributes to a group-specific good x, and each member in group 2 contributes to the production of a group-specific good y. We call these goods club goods, and the consumption of these goods is identical for all members of a group. These goods should be interpreted broadly. They may be tangible in the sense of physical symbols of the group or they may be less tangible embodied in political stances. For example a tangible club good could be a statue and an intangible club good could be the adoption of an extreme position which would be associated with a greater distribution of resources being allocated to the group at the other group's expense. This distinction also makes clear that some types of club good

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[2]This approach is also followed in Hamlin & Jennings (2007), but that paper is less general in that it does not deal with psychological externalities. This paper aims to capture both material and psychological externalities pertaining to inter-group competition.

do not imply any direct material effect upon the other group. Their effect is purely psychological. Other types of club good may be both material and psychological in their effect. So for example, arranging a march to display group identity can only be a negative externality to the extent that it is psychologically provocative to the other group. If relations between the groups were not hostile then the march would have no effect upon the welfare of the other group. We take very seriously the existence of such social psychological externalities. The march would also involve a material externality if it involved, for instance, acts of violence against the opposing group. Our model is intended to be general enough to cover both types of externality. Another example of conspicuous public goods is military spending such as 'presidential guards' or 'honour brigades' that clearly goes beyond or is distinct from that which is necessary to ensure law and order.

For the individual member, the production of these club-goods has a constant marginal opportunity cost c in terms of individual private goods production. These costs should also be interpreted broadly. They could be the present resource cost of building a statue for example. Alternatively, the cost could be more subtle. Some forms of club good may entail a low resource cost today, but due to their provocative nature would entail an increased risk of conflict and higher resource costs in the future. For example, a provocative speech is basically free today but may be highly costly in the future.

The valuation of the club goods produced by both groups depends on the member's type θ^j which we assume to be normally distributed over the group. The objective of member j in group 1 is to maximize:

$$V^j = \theta^j U^1(x,y) - cx \tag{1}$$

where $U^1_x > 0$, $U^1_{xx} < 0$ and $U^1_y < 0, U^1_{yy} < 0$ (throughout the article subscripts denote derivatives). Hence, consumption imposes a negative externality on the other group.[3] In addition, we assume that $U^1_{xy} \geq 0$.

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[3] An extreme form of $U^1_x > 0$ - but may be very relevant in our context - is 'schadenfreude': the consumption of your public good gives you pleasure only because it creates a negative externality on the other group. However, to study these

When positive, this is the KUJ-effect: for a member in group 1, an increase in the level of public goods production y by the other group raises the willingness to produce good x. In other words, the production and consumption of good x (y) is conspicuous when it raises the marginal benefits of the production and consumption of good y (x). To make the distinction clear between externalities and conspicuous consumption, think of the provocative march mentioned above. A march by the other group may not have a direct negative effect on members of the group, however, it may raise their willingness to engage in a march themselves.[4]

The set up of the utility function means that types with a higher preference for the club good are willing to spend more on it at the margin. In addition since $U_y^1 < 0$, those most dedicated to the group will be most negatively affected by rival group club good production. Further, since $U_{xy}^1 \geq 0$, a higher θ increases 'hawkishness' in that such a person increases public goods consumption more for a given increase of consumption by the other group.

The leader of the group decides on the production of the club good – and so implicitly on the production of private goods. When elected, we assume that in the relevant range the leader faces no endowment constraints for the production of club goods. Further, he neither cares for the rents from office (ego or monetary), nor for re-election. He then maximizes his utility and distributes the costs equally over the group members.

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phenomena it is more useful to construct functions with interdependent utility, such as those which incorporate inequity aversion (Fehr & Schmidt, 1999). With respect to schadenfreude or envy (the opposite of inequity aversion), by using experiments Rustichini (2007) shows that when outcomes can be observed people are most happy when they win and others lose. This is a noticeable result, as experiments show that there is little difference between the outcome in which everybody wins or in which everybody loses.

[4]Clearly, in mathematical terms it is difficult to come up with a specific utility function that has both the properties $U_y^1 = 0$ and $U_{xy}^1 > 0$. Hence, most functions have conspicuous consumption together with negative externalities. Note also, for mathematical reasons, $U_{xy}^1 = U_{yx}^1$. The intuition is that the psychological marginal disutility of consuming y is less for own increases in x in the same way that the psychological marginal utility of consuming x is increased by the other group's consumption of y.

4   Equilibrium with Sincere Delegation

Suppose that there is a sufficiently large set of potential leaders available, such that each member can select a leader of his choice. With sincere delegation, each member prefers a leader that has equal preferences to those of himself and supports such a candidate. In that case, from the logic of the median voter theorem, we assume that a leader with a preference equal to those of the median member $\theta^p = \theta^m$ is selected. The leader chooses x to satisfy the first-order condition:

$$\theta^{m1} U_x^1(x^{*d}, y) = c \tag{2}$$

In the decentralized equilibrium there is oversupply of local public goods x^{*d}. To see this, consider what will happen with centralized policy-making and sincere delegation. We assume that when groups cooperate, the two leaders with median preferences maximize their joint welfare $V_j = V_i^m + V_{-i}^m$. Following the assumption on the distribution of the preferences, maximizing V_j also implies socially efficient production. Maximizing V_j gives the first-order condition for good x:

$$\theta^{m1} U_x^1(x^{*s}, y) = c - \theta^{m2} U_x^2(x^{*s}, y) \tag{3}$$

Clearly, as $U_x^2 < 0$ comparing (3) to (2) shows that in the decentralized equilibrium x^{*d} is too high, since it is higher than x^{*s}.

5   Equilibrium with Strategic Delegation

With respect to the policy-making process, we follow Besley & Coate (2003) in that the median group member strategically delegates leadership. The reason for delegation is that the median member sees the appointment of a leader as a strategic choice, as it may affect club goods supply by the other group. Delegation serves as a commitment to a policy stance that would not be credible when the median member herself would be the leader.

The set up of the policy-making game is that in the first stage a leader is selected by the median member taking account of how the preferences

of the leader affect club goods supply. As we do, most of the papers that use strategic delegation to analyze policy choice assume that the median member of a group can choose from a set of leaders where the optimal leader is interior to this set and is available for office.[5]

In the second stage the delegate in each group decides on the optimal level of local public goods. The crucial assumption is that leaders once in office are free to choose the appropriate actions that maximize their individual 'intrinsic' utility from policy. This means that policy actions by the leader are neither contractible by offering monetary rewards nor is there an implicit contract that results from the desire for re-appointment.

5.1   Decentralized Policy-Making

In the second stage the two leaders maximize utility. This gives the two first-order conditions:

$$\theta^{p1} U_x^1(x,y) = c \tag{4}$$

$$\theta^{p2} U_y^2(x,y) = c \tag{5}$$

In stage 1, the median member in group 1 is interested in what the effect of a leader's preference is on club goods production in both groups. Focussing on the choice of the median member of group 1, the optimal preferences of the leader maximize:

$$\frac{\partial V^1(\theta^{m1})}{\partial \theta^{p1}} = \theta^{m1} \frac{dx}{d\theta^{p1}} U_x^1 + \theta^{m1} \frac{dy}{d\theta^{p1}} U_y^1 - \frac{dx}{d\theta^{p1}} c = 0 \tag{6}$$

$$\Rightarrow \theta^{m1} \left[U_x^1 + \frac{dy}{dx} U_y^1 \right] = c$$

Taking total derivatives of the first-order conditions (4) and (5) gives:

$$\begin{bmatrix} \theta^{p1} U_{xx}^1 \, \theta^{p1} U_{xy}^1 \\ \theta^{p2} U_{yx}^2 \, \theta^{p2} U_{yy}^2 \end{bmatrix} \begin{bmatrix} dx \\ dy \end{bmatrix} = - \begin{bmatrix} U_x^1 \\ 0 \end{bmatrix} d\theta^{p1}$$

in the symmetric equilibrium $\theta_1^p = \theta_2^p = \theta^p$. Applying Cramer's rule we

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[5]In contrast to our paper and to Besley & Coate (2003), Besley & Coate (1997) consider endogenous entry of candidates.

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derive the following comparative static results:

$$\frac{dx}{d\theta^{p1}} = \frac{1}{D}\left[-U_{yy}^2 U_x^1\right] > 0 \tag{7}$$

$$\frac{dy}{d\theta^{p1}} = \frac{1}{D}\left[U_{yx}^2 U_x^1\right] \geq 0 \tag{8}$$

$$0 \leq \left(\frac{dy}{dx}\right)^d = \frac{U_{yx}^2}{-U_{yy}^2} < 1 \tag{9}$$

where $D = \theta^{p1}\left(U_{xx}^1 U_{yy}^2 - U_{xy}^1 U_{yx}^2\right) > 0$ is assumed. This is a quite reasonable assumption as it implies that $-U_{xx}^1 > U_{xy}^1$ and $-U_{yy}^2 > U_{yx}^2$. This means that an additional unit of own group club good has more effect on marginal utility than an additional unit of the other group's club good. Note that stronger preferences of the leader only raise the public goods production in the other group if there is a KUJ-effect ($U_{yx}^2 > 0$). The intuition is that stronger preferences for the public good of the leader in group 1 increases the supply of good x. In turn, this increases the marginal utility of y for the leader in group 2, which results in a higher production. Clearly, the third row shows that the increase in y following an increase in x is higher when the KUJ-effect is large.

Proposition 1 *When there is a 'Keeping Up with the Joneses' effect ($U_{xy}^1, U_{yx}^2 > 0$) and there are negative spill overs ($U_y^1, U_x^2 < 0$), decentralized policy-making results in delegation to a leader who has a lower preference for club goods than the median member of the group ($\theta^p < \theta^m$).*

By taking the comparative static result in(6), using that $\theta^{p1} U_x^1(\theta^p) = c$ in stage 2 and economizing on notation, it follows that:

$$\theta^{m1}\left[U_x^1(x,y) + \frac{dy}{dx}U_y^1(x,y)\right] = c = \theta^{p1}U_x^1 \tag{10}$$

$$\frac{\theta^{pd}}{\theta^m} = \frac{U_x^1(x,y) + \frac{dy}{dx}U_y^1(x,y)}{U_x^1} = 1 + \frac{\frac{dy}{dx}U_y^1(x,y)}{U_x^1} \leq 1 \tag{11}$$

Since $U_y^1 < 0$, if $dy/dx > 0$ it follows that the median group member delegates to a leader who cares less for the public good than himself ($\theta^{pd} < \theta^m$), where the superscript d reminds us that we are analyzing

decentralized policy-making. The reason is that by doing so, the median member commits to lower public goods production in her own group *and lower production in the other group.* Hence, the benefits from lower costs plus the gain in utility from lower supply by the other group are higher than the loss in utility from lower club goods supply by his own group. When compared to the decentralized equilibrium without delegation in (2), the level of club goods is lower in the presence of strategic delegation. However, by comparing (10) with (3) we can see that decentralized supply is too high because $dy/dx < 1$.

5.2 Centralized policy-making

When groups cooperate, we assume that the leaders agree by mutual consent on club goods supply. Hence, they maximize their joint welfare $U^j(\theta^p) = \theta^{p1}U^1(x,y) + \theta^{p2}U^2(x,y)$. This provides the two first-order conditions for the optimal x and y:

$$U_x^j = \theta^{p1}U_x^1(x,y) + \theta^{p2}U_x^2(x,y) = c \qquad (12)$$

$$U_y^j = \theta^{p1}U_y^1(x,y) + \theta^{p2}U_y^2(x,y) = c \qquad (13)$$

The set up of centralized policy-making follows the structure of 'consociational' policy-making in divided societies, an approach that gained prominence in political science in the 1980s and was consequently practiced in the peace initiatives that we discuss later in the article (Bose 2007: 74). It has three major pillars. First, government should be a grand coalition between groups encompassing their elites. In addition, there should be 'segmental authority' which could take a territorial or non-territorial form. In practice this could also mean a fiscal authority at the local level. Last, groups should hold veto rights on issues that they consider to be in their basic interests. These assumptions on centralized policy-making are behind the first-order conditions (12) and (13).

To derive the cooperative static effects for club goods supply in equilibrium, we totally differentiate the first-order conditions, noting again

that in symmetric equilibrium $\theta^{p1} = \theta^{p2} = \theta^p$ to give:

$$\begin{bmatrix} \theta^p U_{xx}^j & \theta^p U_{xy}^j \\ \theta^p U_{yx}^j & \theta^p U_{yy}^j \end{bmatrix} \begin{bmatrix} dx \\ dy \end{bmatrix} = - \begin{bmatrix} U_x^1 \\ U_y^1 \end{bmatrix} d\theta^p$$

Hence the comparative statics results for centralized policy-making (noting that $U_{xy}^1 = U_{xy}^2$) are:

$$\frac{dx}{d\theta^{p1}} = \frac{1}{J} \left[-(U_{yy}^1 + U_{yy}^2)U_x^1 + (U_{xy}^1 + U_{xy}^2)U_y^1 \right] > 0 \qquad (14)$$

$$\frac{dy}{d\theta^{p1}} = \frac{1}{J} \left[(U_{xy}^1 + U_{xy}^2)U_x^1 - (U_{xx}^1 + U_{xx}^2)U_y^1 \right] > 0 \qquad (15)$$

$$\left(\frac{dy}{dx} \right)^c = \frac{U_{yx}^2 - \frac{U_y^1}{U_x^1}(U_{xx}^1 + U_{xx}^2)/2}{-(U_{yy}^1 + U_{yy}^2)/2 + \frac{U_y^1}{U_x^1}U_{yx}^2} < 1 \qquad (16)$$

where $J = \theta^p \left(U_{xx}^j U_{yy}^j - U_{xy}^j U_{yx}^j \right) > 0$ is assumed.

Proposition 2 *When there are negative spill overs ($U_y^1, U_x^2 < 0$), centralized policy-making results in delegation to a leader who has a stronger preference for club goods than the median member of the group ($\theta^p > \theta^m$). The incentives for delegation to such a 'club goods loving leader' are decreasing in the KUJ-effect.*

In stage 1 the median member maximizes his utility by choosing the preferences of the leader. These preferences again maximize (6). Using the comparative results of this section it follows that:

$$\theta^{m1}[U_x^1 + \left(\frac{dy}{dx} \right)^c U_y^1] = c = \theta^{p1}U_x^1 + \theta^{p2}U_x^2 \qquad (17)$$

$$\frac{\theta^{pc}}{\theta^m} = \frac{U_x^1 + \left(\frac{dy}{dx} \right)^c U_y^1}{U_x^1 + U_y^1} \geq 1 \qquad (18)$$

Hence, the median voter delegates to a person with stronger preferences for the club good than himself, and the superscript c reminds us that we are analyzing centralized policy-making.

It is instructive to compare (11) and (18) in order to shed more light on the effectiveness of delegation under the two regimes. By this

we mean the extent to which the median voter will choose extreme leaders. Imagine first a world in which there is no KUJ effect ($U_{yx}^2 = 0$). For the decentralized case we can see from (9) and (11) that there is no delegation $\theta^{pd} = \theta^m$. In the centralized case we can see from (16) and (18) that $\left(\frac{dy}{dx}\right)^c$ is negative and that there is delegation to a club-good lover. Equation (15) clarifies this point. Group 2 would simply be reducing y as an internalization of the externality and group 1 would be able to increase x without provoking a KUJ response on the part of group 2 (reflected by the second term in (14) dropping out). Our interest though is in the significant existence of the KUJ effect. As we allow it to increase we can observe two main effects. The first effect is that the effectiveness of delegation becomes less in the centralized system and greater in the decentralized system. Note that $\left(\frac{dy}{dx}\right)^c$ and $\left(\frac{dy}{dx}\right)^d$ are increasing in the KUJ effect. From (18) we can tell that θ^p becomes closer to θ^m and from (11) we can see that they become further apart. The intuition is clear. In both cases an increasingly moderate choice of leader makes sense because of the KUJ effect provoking over production of x and y. It is just that in the centralized case, the leader moves towards the median voter from the club-good loving end of the spectrum and in the decentralized case the leader moves away from the median voter towards the non club-good loving end of the spectrum. The second effect to note is that the rate of increase in $\left(\frac{dy}{dx}\right)^c$ is greater than for $\left(\frac{dy}{dx}\right)^d$ because the KUJ effect additionally reduces the value of the denominator in (16).

Note though that because in (16) we have assumed that $-(U_{xx}^1 + U_{xx}^2)/2 > U_{yx}^2$, it is the case that dy/dx is always smaller for centralized policy-making. The implication is that delegation to a person with stronger preferences is more effective, since the negative effects of a rise in y are internalized at the centralized level. These incentives are declining in the KUJ effect since this would raise the change in y for a given level of increase in x.

6   Summary and Discussion of the Results

The overall conclusion is that centralization of policy-making in the presence of externalities and rivalry dramatically alters the strategic delegation decision. When there is decentralized policy-making, voters take account of the rivalrous feelings in the other group. Hence, they select leaders who are moderates. However, when the negative externalities imposed on the other group are internalized, group members alter their leadership choice and select leaders who are extreme. It will be useful to summarize the results of the model in terms of conspicuous public good production (oversupply or efficient supply) and welfare ranking (in terms of the extent to which public goods are oversupplied) as in Table I.

Table I: Summary of the results.

	Decentralized policy-making	Centralized policy-making
Sincere voting	Oversupply (equation 2)	Efficient (equation 3)
	Fourth-best	First-best
Strategic voting	Oversupply (equation 10)	Oversupply (equation 17)
	Second-best	Third best

Clearly, in the presence of a commitment to sincere voting, the first-best can be achieved by policy centralization, so as to internalize the externalities of conspicuous public goods (CPG) consumption. For all other situations, CPG consumption is higher than in this first-best. The worst outcome arises when in a decentralized policy-making framework the median voter himself is in office, since then policy-making produces high externalities on the other group.[6]

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[6]To connect these welfare effects to the results of the previous sections, recall that the first-order condition for the median person in group 1 is $\theta^{m1}[U_x^1 + (dy/dx)U_y^1] = c$. In the symmetric equilibrium $x = y$, which implies that when when we compare the decentralized with the centralized outcome for a given θ^m, if dy/dx is higher, then x in that case is lower, since U_y^1 is negative.

Note that we are only considering the case where (16) is positive, that is, we are considering only situations where the KUJ effect is significantly present. Were it to be low or non-existent, strategic voting under centralized policy making would be the fourth best outcome.

The most intriguing result arises in the bottom row. In the presence of strategic voting, centralization reduces welfare. The intuition is that centralization reverses the delegation decision. But in addition, centralization also internalizes policy externalities, which makes delegation to a person with stronger preferences more effective. The combination of these two effects means that centralization reduces welfare when compared to decentralized policy-making. Further, we have noted that these effects are less strong for higher levels of conspicuousness of the goods (a higher value of U_{xy}). The reason is that the increase in x that follows delegation also raises the supply in the other group. Hence, this reduces the incentive to delegate to a club good loving leader and thus improves the centralized policy outcome. It also implies that centralization may be less bad in societies that place a high value on the conspicuousness of club goods when compared to private consumption.

However, the baseline result of the article is that strategic delegation reduces the benefits of centralization, since there is an incentive to delegate to a policy maker with higher preferences for the public good. By contrast, decentralized policy-making may produce better results than expected, for groups discount the positive reaction of others that comes about because of the selection of a more moderate leader.[7]

The implications of strategic delegation for the effectiveness of cooperation might be depressing at first sight. However, there may be options in the constitutional stage to resolve the problem. First, when policies are coordinated, in the constitutional stage it might be possible to impose spending limits on the decentralized production of conspicuous public goods. Referring to Besley & Coate (2003) it may not be a

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[7]Although this result may at first strike the reader as extreme, it actually is well in line with recent preliminary empirical work by Collier & Rohner (2007). They show that peaceful settlement of civil conflict often results in increased violence afterwards (riots, assassinations, etc.). The explanation they give for this is very compelling when they argue that it is due to the fact that democratic settlement produces a winner (often the incumbent) and a loser (the rebel leader). When the latter contests the outcome because of vote rigging, violence increases when compared to the relatively quiet period before the elections. We argue that an additional explanation for this fact is that a process of peaceful settlement of civil conflict may alter the leadership structure within both rival groups towards the dominance of more extremist front men.

good idea to centralize funding, for this would create a common pool effect which increases the incentives for strategic delegation. However, this would only work for the production of conspicuous public goods which entail a large construction cost. The costs for many conspicuous actions are not in their construction, but in the potential future costs that may arise through the increased risk of conflict.

A second option is to *ex ante* impose policy uniformity. Our results crucially depend on the assumption that centralized conspicuous public goods supply can be differentiated among groups. If there is no scope for differentiation, this takes away the incentive for strategic delegation. To some extent this solution is a political version of Oates (1972) decentralization theorem. In his work it is the fact that local preferences may differ that may make centralization inferior, even in the case of externalities. In our article, it is the potential for preferences to be different at the centralized level that triggers delegation so as to reduce welfare. A third related solution is to delegate to a single policy maker who does not originate from one of the groups, the external broker.

Fourth, hard fiscal rules at the centralized level can prohibit the excess production of public goods. However, they do not reduce the incentives for strategic delegation, for each group would like to obtain a larger share of the cake. Indeed, hard fiscal rules would magnify the incentives for delegation, as the marginal benefits of public goods are higher. Finally, one might argue that the form of centralization depicted here is highly simplified. There may be further institutional devices that could be created which would overcome the problem of strategic delegation. This point will be stressed in the next section. In that section, we will provide an analysis of two conflicts, one of which we will argue conforms to the main results of our model (exhibiting both strategic delegation and bad for welfare) and another where there is strategic delegation, but the welfare results are better, but not as good as might have been hoped.

7 Applications

The wider implication of our theoretical model is that the constitutional setting in (ethnically) fractionalized countries matters for electoral outcomes. In this section, we discuss whether federalism has affected leadership choice in Europe's two most recent violent civil conflicts. First, we start with the conflict in Northern Ireland and discuss the effects of the Belfast agreement which 'forces' Protestants and Catholics to work together. We show that this has reduced political support for moderate political parties. Second, we consider the reverse case of Yugoslavia, where we argue the delegation to extremist leaders accelerated the decline into war of the Balkans. In addition, we argue that breaking up the Yugoslav federation has led to the selection of more moderate leaders.

7.1 The Belfast Agreement

Northern Ireland had its own parliament from the partition of Ireland in 1920 until its suspension in 1972. However, there is no meaningful sense in which this parliament could be described as centralized in the terms of our model. It was run largely for the benefit of Unionists and fairly blatant gerrymandering was engaged in to maintain this state of affairs. Effectively, this was a period of decentralized decision-making by the Unionist and Nationalist populations.[8]

Both groups engaged in group-specific activities. On the Unionist side the Northern Ireland state sanctioned holidays on days of Protestant significance, the building of statues and the state itself could be viewed as a Unionist club good. This could be seen in the discrimination against Catholics and the almost exclusively Protestant police force, the Royal Ulster Constabulary (even its name generated hostility in the Catholic community). On the Catholic side, there was a tendency to opt out of trying to achieve their goals though the state and they focussed on developing their own newspapers, Gaelic sports clubs, education and so on. This caused antagonism amongst many Unionists who felt more

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[8]There are numerous references on the history of Northern Ireland, examples are Hennessey (1997) and Mulholland (2002). For a more analytical approach see McGarry & O'Leary (1995).

effort could be made by Catholics to integrate, which would in turn reduce the need to protect the existence of Northern Ireland through gerrymandering and discrimination.

Simmering resentment spilled over into widespread violence in the late 1960's and political violence became the depressing form of group interaction for roughly the next 25 years. Throughout this whole period there was a reasonable amount of open and substantial tacit support for political violence on both sides but there was not a strong tendency to support extremists in elections. In line with our model we interpret this as a realization on the part of voters that the destructive nature of decentralized group interaction could be offset to some extent by voting for moderates who will tone down the violence and possibly even find a peaceful solution.

Such an event finally emerged with the signing of the Belfast Agreement in 1998. However, after 1998 there has been a clear movement towards the more extreme Democratic Unionist Party (DUP) and Sinn Fein and away from the more moderate Ulster Unionists (UUP) and Social Democratic and Labor Party (SDLP). Table II shows vote shares in Westminster elections since 1983 and demonstrates the point.[9]

Table II: Election results for Northern Ireland, 1983-2005.

	1983	1987	1992	1997	2001	2005
UUP	34	37.8	34.5	32.7	26.8	17.7
DUP	20	11.7	13.1	13.6	22.5	33.7
SDLP	17.9	21.1	23.5	24.1	21	17.5
Sinn Fein	13.4	11.4	10	16.1	21.7	24.3
Alliance	8	10	8.7	8	3.6	3.9

Perhaps under centralized decision-making the electorate of Northern Ireland prefers to elect hard-line negotiators when they believe that there is little likelihood of a resumption of political violence (in line with Proposition 1), but are inclined to vote for moderates when conflict exists in an effort to secure peace (in line with Proposition 2). Until the recent restoration (May 2007) of devolved government in Northern Ireland, a particular irony existed in that before the Belfast Agreement

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[9]Data from http://www.ark.ac.uk/elections.

the province was governed by direct rule from Westminster. But then when legislation was put in place for devolved government, the two communities selected leaders who could not agree upon sharing power, so Northern Ireland was, once again, governed directly from Westminster. Also at the ground level there have been moves towards greater group distinction, for instance in response to funding for the promotion of the Irish language, Protestants have responded by demanding funding for the promotion of Ulster-Scots. Mulholland (2002: 151) writes 'Many commentators in the summer of 2001 thought that the gulf between the two communities - in their aspirations and social lives - to have been wider than at any time in the previous 30 years.' This is precisely the sort of outcome that this article predicts.

In terms of the model, the welfare implications (as outlined in section 6) do not seem to fully hold in the case of Northern Ireland. While we have argued that the movement from non-cooperative to cooperative environments may not bring as significant a change as might have been expected or hoped for it would be extremely difficult to argue that the situation is worse than before power-sharing. So what does the model not capture? Recall that the model presents costs in a very general way. In conflictual societies, a cost of choosing an extremist is not so much resource costs incurred today but rather the costs associated with a higher probability of future conflict. However, this clearly depends upon the ability of cooperative institutions to remove the potential for future conflict. This may be a premature judgment but it could be argued that the Belfast Agreement has been successful on this crucial front.

The three strands of the Agreement address internal power sharing (strand 1), the relationship with the Republic of Ireland (strand 2) and the relationship with the regions of Britain and Ireland (strand 3). The second and third strands could be viewed as institutions that take the heat out of the conflict (by providing assurances to the two communities) and thus provide the space for strand 1 to operate. Nonetheless, and in line with our model, it is likely to have been the hope of those who designed the Belfast Agreement that it would provide for greater community integration rather than a swing towards extreme parties and

the entrenchment of Loyalist and Nationalist sentiment. In the following section we will see an example where the results of our model would seem to be confirmed.[10]

7.2 The Break-up of Yugoslavia

A main prediction of our model is that federalism could potentially increase conflict through leadership choice. A case in point are the developments in the Federal Republic of Yugoslavia after the second world war. Many authors attribute a significant part of the civil conflict in the 1990s to the constitutional set up of the country in the period 1962-91.[11] After the war, Tito's communists were well aware of the nationalist tensions between the individual regions. For this reason, they set up a federalist structure that decentralized significant parts of policy execution to the Republics. To some extent, the country was divided along ethnic lines (Serbs, Croats, Muslims, and Albanians). However, geographically concentrated minorities (especially Serbs) existed within the provinces. Later, the treatment and discrimination of these minorities turned out to be an important cause of regional adversity.

At the federal level, policy coordination was concentrated in the hands of the presidency, that consisted of representatives from the Republics, in which individual members held veto power. In her introduction, Ramet (1992: 16) notes that, after the federalist structure was imposed, "the republics and autonomous provinces increasingly became spokespersons of their titular nationalities". In summarizing the political science literature Robinson, Engelstoft & Pobric (2001: 961) conclude "...the Yugoslav constitution effectively enshrined each part of the Federation as an area for politics, and ultimately enabled the orthodoxy of nationalism to replace the orthodoxy of communism". The result was the rise to power of nationalists at the first free local elections in 1990: Milosevic in Serbia, Tudjman in Croatia, and Izetbegovic in Bosnia-

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[10]For a deeper analysis of the Belfast Agreement see McGarry (2001) and Jennings (2007).

[11]See Ramet (1992) for an elaborate treatment of the effects of federalism in Yugoslavia. Silber & Little (1996) provide a detailed account of the collapse of Yugoslavia.

Herzegovina.

Many stress the ethnic roots of the conflict between the Republics, however, conspicuous public goods, the redistribution of funds from the federal budget, and large differences in economic development also played an important role. For an example of conspicuous public goods, Ramet (1992) documents the rise of regional airlines. Until 1961 there was only one airline in Yugoslavia, the *JAT*, with its headquarters in Belgrade, Serbia. Regional nationalism created demand for independent airlines. When, after several financial crises, the Croatian government restarted a nationalized regional airline in 1978, Ramet (1992: 164) notes on Croatia's *Trans Adria* company: '[Trans Adria] was, in a word, a "political factory" of the 1980s – an enterprise whose value lay not in the services it provided, but rather in its mere existence as a *Croatian* airline.' A second example were the rows in the presidency over the spending of federal funds for regional redistribution (the FADURK) on railway and road construction. Most prominent were the clashes over the Belgrade-Bar railroad, which to many made little economic sense, but redistributed a significant part of FADURK to Serbia and Montenegro.

Tensions between the republics escalated in civil war, which left Yugoslavia devastated in the 1990s. After a short spell of hostilities between Belgrade and Slovenia, the first war broke out between Serbia and Croatia. After that, civil conflict between Serbs and Muslims ruined Bosnia-Herzegovina and killed many in Kosovo. At the end of the 1990s, after the war in Kosovo, the Republics can be considered independent states. Did this reduce nationalist tensions? In Serbia, the former communists lost power to the opposition led by Djindjic and Kostunica. In Croatia, where nationalists had won the war, Tudjman's HDZ party lost against the liberal opposition, only to regain some ground after the opposition broke up following internal quarrels.

The exception is Bosnia-Herzegovina. After the Dayton-agreement of 1995, Bosnia was governed as a federation by a presidency consisting of a Muslim, a Serb and a Croat representative. The Republika Srpska (the Serbian part) consistently elects extreme nationalists who are blocked from office by NATO's high representative. On the Muslim

side, Izetbegovic remained in power. Nationalist tensions in Bosnia run strong, and the regions fail to agree on a new constitution. Robinson, Engelstoft & Pobric (2001) record new conspicuous actions by the Muslims in Sarajevo: many roads are renamed to reflect Bosnian nationalism and symbols on money bills for Bosnia refer to Muslim superiority over the Serbs.[12]

Bose (2007) discusses many more examples where rival groups fight over 'contested lands'. Systematically the issues discussed in this article return in his work. For example, the Annan peace plan for Cyprus in 2004 produced an overwhelming electoral victory for Greek-Cypriot politicians with a rejectionist agenda, as the Greek-Cypriots did not see it as a last chance to forge a settlement. The plan was killed. The history of Sri Lanka brings to the fore that violence helps moderates. However, any formal peace initiative proposed by these moderate politicians – such as those in 1957, 1965, 1970, and 2005 – induces the Sinhalese-Buddhist majority in the south to fall for 'competitive chauvinism', so that the most extremist leader wins.

Relating to our earlier example of 'presidential guards' and 'honour brigades' is the possibility that these are in effect the price that is paid to extremists who are more attractive to voters when peace is secured. A rather depressing implication of the model is that moderates are attractive when regions are ripe for conflict, but conflict does not promote development. In contrast, when conflict is less likely potential investment for development may be crowded out by spending on expensive, unproductive conspicuous goods such as those mentioned above. A problem that this article poses is the following. How can a system be designed in such a way so that moderates become electable even when the chances of conflict subsides?

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[12]Given these strong identities in Bosnia, Caspersen (2004) argues that consociational approaches have been more effective in fostering stability than integrative approaches.

8 Concluding Remarks

In a theoretical model we showed that when public goods are conspicuous by nature, decentralized decision making causes supply to be too high. Centralization of decision making potentially solves this problem. However, when we allow for endogenous leadership selection, the picture changes. In the decentralized case, voters may realize the externality and the resulting perverse symmetric outcome. Hence, they have an incentive to commit to lower spending by electing a more moderate leader than the median of their group. Consequently, overspending on conspicuous public goods will be lower. This delegation effect is reversed under centralized decision making. Voters anticipate that the externalities are internalized. Therefore, they have an incentive to select a more extreme leader to obtain more public goods than the other group. Hence, centralization and policy coordination may not solve the conspicuous public goods problem. By endogenizing leadership selection we showed that centralization may fail to improve social welfare.

Let us stretch the model somewhat and consider its relevance for policy-making. A first issue is whether decentralization should be promoted in developing countries that are prone to civil conflict. The World Bank is an important promoter of such policies. The standard reasons are that centralized policy-making is slow and bureaucratic, minority rights are not respected, accountability of policy makers is improved, and that many recent empirical studies show that decentralized policy-making results in better economic outcomes. The argument against this reasoning is that these conclusions may hold for relatively high income developing countries but not for LDCs, for there it would increase the chances of civil conflict. As African leaders will agree, decentralization means giving power, money and food to the rebels. Our model points out that these leaders may overlook the fact that decentralization of policy-making can result in more civilized opponents, so as to reduce the chances of violence. The reason is that when decentralization hands over power to local leaders, this gives remote regions where the rebels live an incentive to behave, so as not to give the central government reasons to interfere. This argument could be extended to secession. A more

hopeful message from the article is that where a society does break up the results may not be as bad as anticipated, just as centralization may lead to results which are worse than anticipated (see Tir, 2005). The disintegration, rather than being a force for cementing conflict, may rather be a force for moderation.

A second issue is whether external brokers of peace settlements should promote democracy upon ending the conflict. Clearly, democracy serves as a commitment device to ensure that the opposition's voice is heard. However, critics point to for example Congo, where the settlement between the government and the rebels included elections, which resulted in riot and violence, pushing back peace. Our model points to the fact that it is important to include the leaders who broker the peace agreement (the moderates) in the interim government and postpone elections. This gives the government time to invest in public services, international trade and so on. These investments may deter the electorate at a later stage from choosing extremist leaders.

The bottom line of the article is that peace keeping initiatives that aim to control civil conflict should take into account that such initiatives themselves may influence in an adverse way leadership dynamics. The concept of strategic delegation of leadership should not be taken too literally, for it simply proxies for the incentives in political intra-group dynamics. Hence, whether there are new leaders or existing leaders taking a more hawkish platform perhaps makes little difference to the outcome. In conclusion, the international community may be able to force groups to cooperate under the threat of sanctions. However, they should realize that rival groups may then come to the table with more extreme demands so that efforts to promote cooperation may actually result in deeper polarization. On the other hand, we are not arguing against cooperative agreements but rather that considerable ingenuity in institutional design may be required to provide the safeguards to avoid a potentially worse outcome than would have been the case if the groups had remained (or would become) non-cooperative.

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