

# Solving the Bargaining Democracy Problem Using a Constitutional Hierarchy for Law

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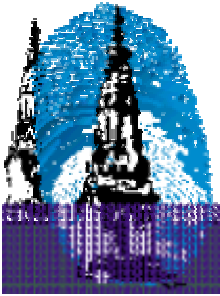
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# LEFIC

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## Center for Law, Economics and Financial Institutions at CBS

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### **Solving the Bargaining Democracy Problem Using a Constitutional Hierarchy for Law**

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## **Solving the Bargaining Democracy Problem Using a Constitutional Hierarchy for Law\***

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### Abstract:

The democratic deficit in the so-called bargaining democracy provides the motivation for constitutional efforts to limit the ability of different groups to form coalitions that are able to grant benefits to themselves through legislation that more or less directly benefit identifiable groups. A constitutional hierarchy of laws that stand in conflict is proposed. In this hierarchy more “rule-oriented” legislation dominate less “rule-oriented” legislation. The main purpose of the proposal is to create a momentum of the political process towards more rule-oriented policy actions and legislation, and to inspire the policy debate to focus on principles and rules to an increasing extent. At the same time, the difficulty of defining a rule as opposed to an outcome-oriented directive is avoided by limiting the task of a constitutional court to simply rank conflicting policy actions with respect to the degree actions satisfy criteria for rules.

*"Democracy is in danger when voters can vote money to themselves"*  
(Alexis de Toqueville, 1835-40)

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## 1. Introduction

*“The state is a two-edged sword: The existence of a state is essential for economic growth; the state, however, is the source of man-made decline.” (North, 1981, p, 20)*

The concept of the “bargaining democracy” was coined by Hayek (1973) to describe the current political systems in the western democracies. He challenges the notion that current democratic governments deliver results that can be said to represent the majority's will. The essence of the argument is that the ability to form majorities for political decisions with respect to specific social objectives favored by specific groups leads to a “bargaining democracy” in which the outcome of the political process cannot be said to represent the majority's preferred outcome.

The political debate on both sides of the Atlantic Ocean reflects criticism of the democratic process which to some extent accords with Hayek's view of the bargaining democracy. In the United States campaign finance reform is viewed by many as a way of reducing the influence of particularly well organized and well funded lobby groups on the political process. In parliamentary democracies like Sweden economists and political scientists alike have argued that the result of the democratic process is more representative of the will of a few strong interest groups than of “the will of the people”.<sup>1</sup> In both cases the democratic deficit is viewed as a result of the capture of the political process by particularly well funded and well organized groups.

The criticism of the democratic political process implied by concept of the bargaining democracy is more far-reaching. It is based on the ability of groups to form coalitions which can and inevitably will grant benefits to the members of the coalition at the expense of non-members.<sup>2</sup> Thus, the criticism would stand even if all individuals had the same ability and means to become members of the majority in power. It is the ability of the government to grant benefits to individuals and groups that inevitably will be the cause of a dynamic political process wherein many majority decisions are made although the decisions in themselves do not have the support of the majority.

In recent years Buchanan (e.g. 1993) and Hayek have argued that majority rule can be made to reflect the “will of the people”--in Hayek's words--only if majority political decisions are limited to “rules of just conduct” applicable to all citizens as opposed to political decisions aimed at specific social objectives favored by identifiable groups.<sup>3</sup> Both Buchanan and Hayek have proposed constitutional solutions to reduce the democratic deficit of the bargaining democracy. Their constitutional proposals are based on constraints being made on the type of decisions legislatures make by means of majority votes.

In this paper an alternative constitutional proposal for resolving or reducing the bargaining democracy problem is put forward. Under the proposal there are no constraints on the type of decisions subject to majority vote in the legislature. Instead a hierarchy of legislative decisions is proposed. More “rule-oriented” decisions dominate less “rule-oriented” decisions.<sup>4</sup> A constitutional definition of

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<sup>1</sup> The Lindbeck Commission (1996) emphasizes the link between the influence of strong interest groups and the relative economic decline of Sweden. The Swedish Bureau of Economic and Social Research (SNS) publishes annual reports by political scientists focusing on current issues with respect to “the state of democracy”. See, for example, SNS Demokratiråd (1995, 1996, 1997)

<sup>2</sup> Favors and benefits for particular groups need not enrich these groups but may support causes favored by the groups.

<sup>3</sup> In three volumes of *Law, Legiskation and Liberty* Hayek (1973, 1976 and 1979) analyzes and expands on principles for a democratic society with a minimum of coercion of individuals by other individuals and by the state.

<sup>4</sup> A distinction is sometimes made between principles as general formulations of objectives while rules specify actions under very specific circumstances. For example, US accounting standards are called rule-oriented while many European countries have

greater degree of “rule-orientation” of political decisions is required. A constitutional court is charged with the responsibility of resolving inconsistencies between laws in accordance with the principle of the hierarchy. The hierarchy is intended to create political dynamics with increased emphasis on decisions with respect to rules, while bargaining for benefits to identifiable groups would be discouraged.

The causes of the democratic deficit in the bargaining democracy are discussed in Section 2. The possible contradiction between preferences for “rules of just conduct” and preferences for specific policy objectives with respect to identifiable groups is explained. In order to claim that there is a democratic deficit a benchmark is required. A political equilibrium will be defined to provide such a benchmark.

The constitutional proposal is presented in Section 3, while the concept of rule-orientation of legislative decisions is discussed at greater length in Section 4. Hayek (1973) devotes several chapters to define the meaning of a “rule of just conduct” and the differences in political dynamics that result from decisions with respect to such rules and decisions with respect to specific objectives and groups in society. Few political decisions made in legislative assemblies are purely in one category or the other, but most legislation has elements of rules while it to some extent is designed to achieve objectives favored by particular groups.

The growing economic literature on political processes is reviewed in Section 5. Most of this modern economic analyses of political processes rely on assumptions about asymmetry of information between citizens and their representatives, or about transactions costs. It will be argued that the constitutional proposal resolves many of the deficiencies of the political process identified in the economic literature.

Existing constitutional proposals designed to reduce or resolve the problems of the bargaining democracy are discussed in Section 6 and compared to the proposal presented here. It is argued that existing proposals are difficult to implement because they require that a distinction is made between rules and political decisions aimed at specific outcomes for identifiable groups. The dynamics towards increased rule orientation of political decisions require only that legislation can be compared in terms of rule-orientation. Final reflections and summary follow in Section 7.

## **2. The democratic deficit of the bargaining democracy**

*[A situation wherein a] "majority governmenit does not produce what the majority wants but what each of the groups making up the majority must concede to the others to get their support for what it wants itself amounts to... [corruption "] (Hayek, 1979, p. 11)*

In three volumes, Hayek (1973, 1976, 1979) analyzes and challenges the notion that current democratic governments deliver results that can be said to represent the majority's will. Another quote from Hayek (1979, p 99) illustrates his argument with respect to the cause of the democratic deficit: “The cause of complaints is not that the governments serve an agreed opinion of the majority, but that they are bound to serve the several interests of a conglomerate of numerous groups". It is the demands of a multitude of special interests "each of which will consent to the special benefits granted to other groups only at the price of their own special interests being equally considered". These statements apply on parliamentary democracies, as well as on systems with more explicit checks and balances between the executive and the legislative branches of governments, as in the USA. Furthermore, democracies with proportional voting systems and strong political parties, as well as those with majority voting systems and a stronger link between voters and the elected representative are subject to the critique. One has only to read David Stockman's (1983) account of his negotiations as Budget Director in the early years of the Reagan administration, and Kjell Olof Feldt's (1991) review of his years as Finance

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principle- oriented accounting standards. This terminology is possibly mis-leading and will not be used here. Instead rules and principles are nearly synonymous. The concepts are crucial in the argumantation and will be discussed in more detail below.

Minister in the Swedish Social-democrat government 1982-1990 to obtain vivid illustrations of the meaning of the "bargaining democracy" in two different types of democratic government.<sup>5</sup> While the bargaining to create majorities occurs among individual representatives in the U.S., most of the bargaining in parliamentary systems occurs within the political party or parties holding a majority in parliament. Differences between the systems will be discussed briefly below.

The root cause of the democratic problem in modern democracies in Hayek's analysis is the omnipotence of democratically elected governments. Classically liberal principles of separation of powers, the rule of the sovereignty of law, government under the law, the distinction between public and private law, and rules of judicial procedure serve to limit the coercive powers of governments. The principles are still expressed in most democratic constitutions, but they have been eroded and increasingly put aside in the belief that democratic control in the form of competition among, for example, different parties make any other safeguards against government coercion unnecessary.

The competition for political power in democracies has been compared to competition among firms in a product market, where the relevant information for consumers to make informed decisions is made available through the competitive process. Becker (1985), for example, provides an analysis of the competitive political process and derives propositions with respect to the economic efficiency of the process. Thereby, he seems to contradict Hayek's criticism of the bargaining democracy. Efficiency in a welfare economic sense is obtained if the political process is truly revealing to voters about the results of various tax-subsidy schemes, and about the deadweight cost associated with the schemes. Wittman (1995) argues in a similar vein that the argument for the "failure of democracy" is based on the myth that voters do not have the ability to understand the political process and consequences for themselves of different policy measures.

Another strand of economic literature that seems to contradict the criticism of the bargaining democracy refers to log-rolling--the ability of groups or their representatives to bargain among each other for mutual support--as an efficiency enhancing device. Tullock (1969) shows that log-rolling potentially improves the efficiency of the political process relative to a situation when various governmental initiatives would have to be approved one by one by majority voting. Log-rolling enables strength of preferences to influence the allocation of resources under government control. Aggregate wealth increasing actions that would not occur with simple majority voting are made feasible with log-rolling.

An important assumption behind the argument for potential wealth increasing effects of log-rolling is that the range of legislative activity is given. Specifically, the legislature decides on the allocation of collective goods and policies aimed at correcting possible market failures. In modern democracies, however, governments are involved in a much broader range of issues, some of which are purely redistributive and some of which are in the government domain only because various groups have been able to make a case for government involvement. In other words, the existence of collective goods and market failures are not generally the reason for government involvement. It is sufficient that a group or a coalition of groups can gather sufficient political strength for the government to influence economic activities such that the groups are favored. The support of agriculture and the particular channels of this support, as well as the support of specific industries,

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<sup>5</sup> Kjell-Olof Feldt tells, for example, the story about discussions when developing the government's budget for 1990. Discussions were held with two power centers -- the trade union leadership, and the socialdemocrat party's parliamentary group. The finance minister proposed delaying improved parental insurance and delaying a proposed sixth vacation week. In the parliamentary group one half of the members supported the parental insurance and the other half defended vacations. The trade unions could support delaying both reforms if certain tax changes were implemented. The result was that the finance minister could not delay any of the two reforms, each strongly supported by half the governing party's representatives (Pp. 447-450).

are examples of government policies affecting both the allocation of resources and the distribution of wealth without evident market failures.

The literature on log-rolling and Becker's (1985) analysis of the efficiency of the political process do not explicitly address the issue whether the outcome of the political process is preferred to the outcome, had the scope of government activities been different. The main point of Hayek's critique, on the other hand, is as noted that the scope of government activities becomes wider than what a majority would want, because the omnipotence of governments leads to the formation of coalitions seeking to get the government involved in activities that favor them one way or another.

The omnipotence of democratically elected governments has caused a shift in the role of the legislative assembly as the creator of "law". To the constitutionalists laws were traditionally meant to prevent "unjust conduct". They should be equally applicable to all individuals in an unknown number of future instances. Such laws under the domain of the legislative stand in contrast to "directives", and specific commands or privileges referring to particular individuals and groups under the domain of governments. In modern democracies, the power of laying down laws in the above sense, and the power of issuing directives and commands have been placed in the same hands. The term law is used both for law in its original meaning, and for what could be called directives and commands favoring various groups of citizens. Both the executive and the legislative branches are involved in issuing governmental directives and commands under the name of laws but few general rules constrain governments in most countries. Thus, governments in democracies have been empowered to act both in the special and the general interest.

Hayek (1979), as well as Brennan and Buchanan (1985), emphasize that the distribution of income and welfare, resulting from the democratic process, is not likely to correspond to anyone's or the majority's conception of distributive justice nor is it the result of individuals and governments behaving in accordance with generally agreed upon rules of conduct.

The lack of correspondence between the outcome of the democratic process and a general conception of what would be the outcome under some acceptable rules of conduct affect individuals' behavior in both the political and the economic arenas. In the political arena there is a necessity for different groups to watch the process and lobby for benefits in order to obtain a favorable "bargain". If they do not, they nevertheless end up paying for benefits to others. In the economic arena individuals are induced to behave such that they benefit from the structure of benefits and privileges handed out by the government creating deadweight costs and inducing them to violate the rules of conduct they would have subscribed to had others been expected to follow the same rules.

The implication of Hayek's argument is that in a comparison of the majority supported outcome in the "bargaining democracy", and the outcome under majority supported rules of conduct, the majority is likely to prefer the latter, and the dynamics of the "bargaining democracy" discussed above make it increasingly inferior as time goes by. In the language of modern economics there are multiple, political, majority supported outcomes corresponding to different sets of rules of conduct among governments, individuals, and firms. To the extent political decisions are not consistent with citizens' perception of what is fair, the government must apply coercion to implement the decisions. Hayek's criterium for a well functioning democracy is that the degree of coercion applied by the government should be minimized.

The democratic problem can be interpreted as the ability of the political process to generate a majority supported outcome with respect to benefits and costs for individuals and groups which is consistent with their behavior under majority supported rules of conduct. A democratic or political equilibrium could be thought of as the situation when the result of the political process is consistent with the

result of individual and governmental activities constrained only by general rules of just conduct.

A comparison can be made between the democratic equilibrium described above and the economic market equilibrium condition stating that ex post outcomes are consistent with ex ante expectations. In the political process individuals vote ex ante on rules of conduct in their interaction. Ex post, the majority determines which specific groups' objectives will be supported. In the democratic equilibrium the ex post voting on benefits to various groups is consistent with the behavior of individuals under the ex ante rules of conduct. This consistency may be seen as a benchmark for evaluating the quality of the political process. In the bargaining democracy there are strong incentives for a majority to use its power to achieve objectives that are inconsistent with ex ante determined rules of conduct. Also, individuals' behavior under different rules of conduct will be influenced by the knowledge that a majority will favor particular groups ex post. Thus, there is an argument for constraining the power of the majority to grant benefits and favors to various groups.

Would it not be possible or even likely that a political party would arise in the "bargaining democracy" proposing that benefits and privileges to particular groups should be slashed across the board, and that legislation on general principles and rules of conduct should be given priority politically, if a majority actually supports such a program? Such a party may appear, but its days in power are likely to be short without constitutional change. A "political equilibrium" with agreement on principles and rules of conduct would be unstable, because as long as groups or their representatives have the power to bargain for special benefits, there is an incentive to do so. Groups which do not want to participate in the bargaining for potential benefits risk losing out unless all groups agree not to participate. Great certainty about enforcement of the principle that groups should not use the political process to favor their own objectives now and in the future would be required for all groups to abide by the principle.

### **3. A constitutional proposal for a hierarchy of laws.**

*"...today legislatures are no longer so called because they make the laws, but laws are so called because they emanate from legislatures" (Hayek, 1979, page 4)*

The constitutional proposal that follows is offered as a basis for further analysis and discussion. Its effectiveness will not be proven but it will be argued that its implementation will lead to a dynamic political process wherein legislative assemblies will focus on rules of conduct and be discouraged from taking political decisions granting benefits to specific groups in society unless these benefits are consistent with legislated rules of conduct.

The proposal is the following: Establish a general constitutional principle for a hierarchy of legislative action such that legislation with stronger rule-orientation will dominate and overrule conflicting legislation and directives with weaker rule orientation. Degree of rule-orientation is defined by the extent to which legislation satisfies criteria for rules of conduct. A constitutional court with political independence would be charged with the task of comparing the rule orientation of conflicting legislation. The constitution would include criteria for comparing rule-orientation of political decisions. These criteria will be discussed below. They refer in particular to "directedness" of legislation with respect to identifiable groups, and "arbitrariness" in judging when legislation applies. One advantage relative to other constitutional proposals discussed in Section 6 is that the constitutional court need not determine the dividing line between rules of conduct and legislation with specific social objectives favored by groups in society. Instead the constitutional court would be charged with the task of comparing conflicting laws and directives, and judging their relative degrees of satisfaction of criteria for rules. It will be



argued that such a relative evaluation of legislation is much easier than determining whether a legislative decision is a rule or not.

Under this proposal there is no constraint on the type of decisions governments make. Groups or their representatives would be able to bargain for government resources but if another majority would vote for a conflicting law with greater rule-orientation, then the bargain could not be implemented. Assume, for example, that there are three sub-groups in the assembly representing three groups with different interests in society. Two of them negotiate an agreement whereby group One is supported by group Two in a vote on transfers to group One, while group Two receives benefits from protection against competition through support of group One. If group Three opposing both measures could get group One to agree on a general rule prohibiting certain types of protection against competition, then the favors given to group Two would cease at no cost to group one.

The hierarchy would make it risky for groups to enter bargains, because the group that loses a favorable policy action in the constitutional court would still be settled with the costs associated with favors to other groups in the original bargain. In the example above the group losing protection would still be settled with costs for transfers to other groups in the original coalition. Thus, there would be incentives to design policy measures in a general enough way for the measures to gain majority support on their own merits although there would be no constitutional restrictions on the ability to form bargaining coalitions.

Apart from facing risk stemming from a group losing the benefits of a favorable political decision, each group would hesitate to enter a coalition with a group that is seeking highly directed benefits. The reason is that once the coalition has unravelled, any group in it may only have minority support and risk losing its benefits. Thus, the hierarchy would create a political system with a momentum towards rule-oriented legislation. At the same time the system would not rule out policy measures for dealing with market failures. Log-rolling coalitions for truly collective goods or for dealing with externalities should remain stable because general criteria for supplying such services are more easily defined than for policy measures with more directed content. Redistributive policy measures would have to be formulated with transparency primarily as changes in general tax schedules, while redistribution through many small measures without transparency would be discouraged.

An important assumption for the practicality of the hierarchy proposal is that there are few dimensions of the criteria for the ranking of policy measures in terms of rule-orientation. If the ranking depends on three or more criteria, then it is possible that the ranking becomes arbitrary and lose legitimacy. We turn now to a discussion of the meaning and role of rules in order to motivate that lack of directedness and lack of arbitrariness are used as criteria for determining rule-orientation.

#### **4. Politics of Rules and Outcomes**

*"The crucial point is that votes on rules applicable to all, and votes on measures which directly affect only some, have a wholly different character"*  
(Hayek, 1979, p 8)

Constitutional rules define the "social contract" among citizens. An important aspect of this contract is the division of power among the judiciary and the branches of government. Thereby, the public vs. the private spheres of decision-making are determined. What kind of decisions are made by individuals and under what rules of conduct? Which types of decisions are made by the legislative branch, the executive branch, and the public administration and under what rules of conduct? By what means are various rules of conduct enforced? The constitutional contract is decided upon under, at least, a partial "veil of ignorance" about future circumstances of the

individuals, and it determines the scope and the tools of the government's coercion of individuals, and indirectly the scope for individuals' coercion of each other.

The key feature of rules of just conduct emphasized by Hayek is lack of specific social objective favored by identifiable groups in society. Rules apply in an unknown number of future circumstances to individuals who cannot be identified when the rule is set. Thus, they apply the same way independent of the affected individuals' characteristics in terms of income, job, age, etc. Ideally rules would be determined under a "veil of ignorance" creating the likelihood that they will apply equally across individuals. Thus, rules can be said to have little "directedness" in terms of social outcomes favored by particular groups.

Generality is often viewed as a characteristic of rules (e.g. Buchanan, 1993). The term generality leaves room for ambiguity when defining a rule, however. A "law" stating that each individual should, be provided social insurance according to the person's needs may seem to have generality but this "law," is highly outcome oriented, or specific with respect to social objective and social groups. Such a law is therefore "directed" and not a rule of conduct. If a high degree of generality would be the criterion for rules of conduct, the rules would leave room for arbitrariness in the implementation; especially if the right of interpretation is given to by public administrators rather than to courts. A rule of conduct should have predictability with respect to the conditions under which it applies. At the same time, particular results of the rule are largely unpredictable. The social insurance rule above fails in this respect. Thus, a policy decision is increasingly a rule, the less the action is directed towards specific objectives favored by identifiable individuals at the time the decision is made, and the more the decision specifies predictable consequences of specific conduct. The first aspect can be seen as a "degree of cover of veil of ignorance" or "degree of lack of directedness", while the second aspect can be viewed as a "lack of arbitrariness" condition for the implementation of a rule. In combination the two aspects of a rule of conduct lead to a minimum degree of required coercion by the government. The lack of directedness implies that the rule is likely to reflect a majority's sense of moral and fair conduct. The second aspect implies that individuals are able to arrange their activities such that a violation of the rule does not occur. Coercion by the state is required primarily to enforce rules rather than enforcing various measures required to achieve outcomes that cannot be achieved without violation of what most people consider fair conduct.

The veil of ignorance aspect is obviously nearly impossible to achieve perfectly. Similarly, lack of arbitrariness cannot be achieved because all future circumstances cannot be known -- contracts are incomplete in the terminology of modern economics. Thus, if a constitutional court would evaluate whether a policy decision qualifies as a rule, some guidance with respect to the borderline between rules and non-rules is necessary. Dixit (1996) expresses some scepticism about the possibility of drawing a line between decisions with respect to rules and decisions with respect to outcome. Few instances of policy making refer to either pure rules or pure directives affecting outcomes more directly.

This discussion can be related to Dixit's (1996) transactions cost framework for politics. There is little doubt that there are transactions costs associated with the determination of what a rule is. On the other hand, transactions costs in the political process of finding majority support for a rule may be relatively low. One reason is that rules are not suitable for bargaining about favors and the less directed are rules, the less is the scope for exchanging favors by mutual support for rules favored by different groups. A second reason is that the number of alternative rules under political consideration is likely to be smaller than the range of possible directed policy measures. For example, agreement on liability rules with respect to health standards may be relatively easy to reach, while opinions about exact standards may vary. Votes on exact standards can also be used to favor particular producers. Fears that non-tariff trade barriers can be erected by means of health

standards are wide-spread. On the other hand, enforcement costs of liability rules could be higher than enforcement costs of exact standards.

Dixit (1996) views rules as commitments to act in specific ways under well-defined circumstances. Since all circumstances cannot be specified, situations may arise when "breach of contract" is preferable to all involved. In such a case a strong rule commitment could inhibit flexibility. "Loop-holes" in the rule may serve to increase flexibility but the more loop-holes that are built into the rule to begin with the less credible is the commitment. In other words, loop-holes are a source of arbitrariness in the implementation of a rule. These considerations imply that there is an optimal degree of rule orientation of laws and that a constitution should not require the legislature to abide by a specific definition of rules. The constitutional proposal presented above would make it possible for the political process to seek an optimal degree of rule-orientation in each legal area.

One way for the legislature to make rules without creating inflexibility is to make laws enabling rather than mandatory as discussed in Macey(1993) and Wihlborg (1997). Enabling law would dominate mandatory law in the hierarchy proposal. Mandatory law often has a higher degree of "directedness" than enabling law because mandatory law rules in many areas such as corporate-, labor-, and credit market law have the objective of achieving specific outcomes for identifiable groups. For example, labor law specifying a certain order of lay-offs, or a certain number of hours per work-week may represent political favors to specific groups. If the laws were enabling the law would simply specify a "default contract" kicking in if parties cannot come to an agreement about lay-off principles and work hours. Mandatory law then implies a greater degree of coercion and it reduces flexibility to adjust commitments to varying circumstances across individuals and time.

It is obvious that governments cannot limit themselves to determine rules of conduct. By popular consent they must use coercive powers to raise funds through taxation to provide for a number of services, and they issue directives and commands to protect individuals' health, the environment, etc. Hayek does not argue that governments should abstain from the mentioned activities but that the coercive powers to tax and affect the distribution of wealth and the allocation of resources should be constrained by generally agreed upon principles for the conduct of government. Such principles may take the form of constitutional rules but regular law could also be and is used to establish principles for government's tax and expenditure policies. For example, a possible rule when deciding on government expenditures would be that individuals voting for a particular expenditure item should know their shares in the costs. If so, the burden of each individual for expenditures must be known by predetermined taxation rules when expenditure decisions are made. Another rule with respect to government expenditure policy, which has been implemented in, for example, Sweden is that the expenditure ceiling must be determined before expenditures are allocated to various government activities. Votes on such rules for policy making would have a strong rule-orientation and therefore invalidate political decisions that do not abide by the rule.

## **5. Modern Political Economy Analysis and Constitutional Proposal**

The critique of the "bargaining" democracy discussed above relies to a large extent on a dynamic argument about the scope of governments' activities and individuals' responses to the incentives provided by the political process. These arguments are essentially economic although methodologically Hayek is not within the mainstream of economists. The analysis is in many ways supported by modern economic analyses of the political process. A brief review of such analyses follows in this section and the contribution of the constitutional proposal to resolve issues in the literature is discussed.

A negative view among economists of the political process as a substitute for the market process is founded in Arrow's paradox (1951) and generalizations thereof. If the political process is to determine the aggregate preferred alternative among more than two choices, then no procedure for aggregating individual preferences is consistent with minimal sets of normative constraints such as non-dictatorship (Mueller, 1997, p 7). Thus, majority rule may reflect aggregate preferences reasonably well when there is a simple choice between two alternatives but few issues resolved by the political process are of this kind.

One implication of these results with respect to the imperfections of the democratic process based on majority rule is that the dynamics of the process becomes very important. However, there are rarely opportunities given, nor information available to politically reveal preferences between the current situation and what would have been the situation, had the dynamic path been different. The political choice is generally among a set of political actions leading to outcomes within a narrow range in the short run. A choice among dynamic paths, however, or between outcomes over a longer time horizon would have to be translated into a choice among rules of conduct for individuals, firms, and the government. Such choices are rarely given by the political process but the constitutional proposal would increase the rule orientation of the political debate and therefore enhance the choice among dynamic paths.

As noted there exists an economic literature taking a more positive view of the political process. Market failures provide the rationale for political intervention in the allocation process. Only the most hard-core market oriented economists would limit the role of the government to national security and law enforcement. Buchanan and Tullock (1962) - two authors who have been among the leading proponents of public choice analysis - led the way among economists to a constructive economic analysis of the political process emphasizing, like Hayek does, the distinction between analysis of rules governing the political process and analysis of specific measures. Buchanan (1975) in particular has emphasized the role of normative analysis of the rules of the political process -- the constitution.<sup>6</sup> The constitution is a contract established under "a veil of ignorance" about the outcome for individuals of political and economic processes over the lifetime of the constitution. Buchanan's emphasis of normative analysis of rules as opposed to outcomes of the political process is motivated by the deficiencies of political processes for choice among outcomes.

The public choice literature inspired to a large extent by Buchanan has become increasingly formalized during recent decades borrowing its tools from economic analysis under asymmetric information. As Mueller (1997, p. 140) puts it, constitutional democracy can be thought of as "a principal agent problem on a colossal scale". The principal-agent problem exists when two parties in an economic relation have different information and one party - the principal - cannot observe the actions of the other - the agent. If the parties have different objectives then the agent's "opportunistic" behavior in his or her own interest may be welfare reducing. There are conflicts of interest between the parties that may be partially or fully resolved by a contract provided there exists an enforcement mechanism.

In most public choice analyses elected representatives are viewed as agents of the voters who do not possess the information of the representatives. Thus, the latter are able to follow their own agenda to a certain extent. This agenda may include a stronger emphasis on the short term than the voters or it may include power or wealth. In a dynamic context, elections control the opportunistic behavior of the representatives -moral hazard - but only imperfectly. Incentive compatibility between voters and politicians in this context is possible only with the politicians'

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<sup>6</sup> Wicksell (1896) was an early proponent of the so called contractarian approach. He made the distinction between "just procedure" and "just outcomes".

"refusal to vote selfishly" (Ferejohn, 1994) or an enforceable commitment not to vote that way. Such a commitment cannot be made perfectly credible, however.

The principal-agent framework can explain aspects of the "bargaining democracy" described above. Politicians' preferences may be influenced in different ways by specific interests, which for various reasons obtain a stronger weight in the preferences of some politicians than among those they represent. The politicians representing different interests can thereafter bargain within a political party or among themselves to obtain a majority for a group of interests.

Mueller (1989) and Weingust, Sheapshle and Johnsen (1981) shed additional light on so called pork-barrel politics in models where the individual tax-payer bears a small fraction of costs, while benefits of a political action are concentrated. Too many socially inefficient projects gain majority support under these circumstances as would be expected in the bargaining democracy.

Representatives are also imperfectly informed about individuals' behavior. Thus, there is a principle-agent problem with individuals being the agents of their representatives. In this view, people may seek private benefits under the "laws" laid down by representatives, and by seeking benefits on grounds that are only partially observable.

The dynamic problem described by Hayek can be thought of as a time-inconsistency problem in the language of modern economics. Peoples', as well as representatives' inability to credibly commit to rules that would put benefit-seeking from the government out of reach, implies that the temptation to seek the available benefits cannot be resisted. An enforceable commitment "not to vote selfishly" cannot be made by representatives of different groups. The constitutional proposal would be a remedy for this lack of commitment if it succeeds in making groups reluctant to enter bargains for various favors. On the same grounds the proposal would discourage political representatives from entering bargains that are more self-serving when voters are less informed than the representatives.

During recent years economic research has been conducted on the result of political negotiations under different institutional arrangements. One difference being emphasized is between parliamentary democracies and the American system with more far-reaching division of powers between the legislative and the executive branches of government. Persson, Roland and Tabellini (1997) analyze theoretically how well the different systems represent citizens' preferences with respect to collective goods and income distribution, and whether the systems differ in their degree of resource use benefiting only the politicians. One difference is that majority groups within parliamentary systems tend to be formed within reasonably homogeneous political parties, while majority groups are formed among more heterogeneous and varying groups within the US non-parliamentary system. The latter system results in a smaller public sector but also in an under-supply of collective goods.

Baron and Ferejohn (1989) and Persson and Tabellini (1998) analyze factors determining the relative strength of different groups within legislatures, and how different decision rules affect the expenditures of the public sector. A number of groups are seeking to form a winning coalition. The negotiating powers and the ability of different groups to join a winning coalition depend on the tax payments of the groups, which can be used to provide mutual favors, and the degree of satisfaction with status quo.

Another interesting aspect of the bargaining democracy is developed by Chari, Jones and Marimon (1998) who show that within a majority election system the majority in each election district tend to elect a representative with a strong inclination to favor the district when spending public resources. At the same time the representatives would be disinclined to favor other districts than their own. The majority across all districts will prefer the result that all districts elect

representatives with little inclination to spend public funds. However, the majority of representatives will form a coalition favoring a group of districts.<sup>7</sup>

Persson et al (1996) show that the separation of powers among independently elected government bodies -- as between states and the Federal government, and between the executive and the legislative branches in the USA - may contribute to information revelation in the "political market". Thereby, the outcome of the political process may become more "efficient" in Becker's sense described above. Nevertheless, the analysis of the bargaining democracy and the constitutional proposal is applicable on both the American system and on parliamentary systems, and on majority systems as well as proportional systems. In all the systems, the empowerment of governments to act in the special interest makes it an inherent necessity of them to do so although the results of the political processes may vary across systems as the abovementioned economists show.

## 6. Comparing Constitutional Proposals

There exist a number of proposals for constitutional reform. Separation of powers was mentioned above as a tool to enhance the information availability in the political process. Voting rules, such as requirements for qualified majorities were recently suggested by the "Lindbeck Commission" (Lindbeck-kommissionen, 1996) for specific issues in the Swedish context. Such rules would most likely increase the degree to which government actions become rule-oriented rather than outcome oriented. They increase the costs of creating a sufficiently large group that is able to vote for mutual favors. Thus, they increase the transactions costs for the "bargaining democracy". Qualified majorities are most likely easier to gather for rules of conduct than for outcome-oriented actions, because the "veil of ignorance" operates more effectively for rules than for outcomes.

A more far-reaching proposal for constitutional reform has been proposed by Hayek (1979). He outlines principles for a constitution designed both to make the outcome of the democratic process coincide with principles held by the majority and to minimize the degree of coercion in society. The proposal is very simple: Distinguish between legislation proper with respect to rules of conduct, and decisions on directives for government spending, administration, and regulation by separating the two functions into two distinct assemblies elected by entirely different procedures. The government bodies would be subject to general rules of conduct decided upon by the legislative assembly. The model constitution also contains a general declaration of rights, and an important definition of what should qualify as law - a general rule of just conduct. A constitutional court would have to be established to test the appropriateness of the legislature's decisions against such a definition.

The *legislative assembly* would be responsible for the body of criminal and private law, the principles of taxation, general regulations for safety and health, rules to secure competitive markets, corporate law, and the like. The coercive powers of governments would be limited to the enforcement of these general rules and principles.

The *proposal's government assembly* would decide on the use of material and human resources entrusted to the public sector. The size and the general purposes of expenditures would be limited only indirectly by the general rules of conduct set down by the legislative assembly and by people's willingness to pay taxes. The general principles of taxation decided upon in the legislative

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<sup>7</sup> Bennesen and Feldman (2002) compare "equilibrium lobbying" in a party system with votes of confidence and a majority system with little party discipline. They show that lobbying of legislators will be more intensive in the latter system. The authors also note that lobbying can take different forms and occur within the party organizations or be directed at those implementing the majority decisions

assembly would make citizens aware of their share of payments for specific services. This would prevent the current practice of disguising tax burdens to "...make those who will, ultimately have to bear it (the burden) as little aware of it as possible" (Hayek, 1979, p 127).<sup>1</sup>

A critical issue for the constitutional proposal is to prevent the legislative assembly from instituting laws favoring large groups or wealthy interests. Hayek presents a number of suggestions in this regard. Most important, however, is the definition of "law" and the role of the constitutional court in evaluating the constitutionality of legislation against this definition. Hayek's proposal is far-reaching and most likely outside the realm of feasible reforms within the foreseeable future. It is subject to Dixit's (1996, pp 146-68) criticism that "All such arguments [recommendations of better alternatives] should recognize the full set of constraints on policy-making" and that observers as judges of outcomes or systems should not even think in terms of "first best" ignoring transactions costs in political processes.

Buchanan (1996) also considers the general applicability or lack of directedness of rules as a criterion for validity of majority decisions. He focuses on issues of welfare and taxation. Buchanan's general applicability criterion with respect to taxation is obtained by the principle that the majority cannot exempt its own members from liability. With respect to government expenditures for public goods or fiscal transfers the criterion is that the majority cannot restrict access or eligibility to its own members. Even these definitions of general applicability are not easily operationalized. Can a progressive tax system be considered general enough? The answer would depend on who is in the majority voting on such a scheme. If the majority group consists of people who have in common a relatively low income, then, it is obvious that this majority has voted to impose high tax rates on others. Then the tax rule does not have general applicability but directedness. On the other hand, if the majority voting for a progressive system consists of rich as well as poor, then the tax-system can be said to be general.

Could age be a criterion for eligibility for transfers under the generality principle? Buchanan argues "yes" on the grounds that everyone becomes old sooner or later. The same could be said about transfers to sick or disabled. Thus, the main point in Buchanan's interpretation is that a general rule must apply on most everyone now or in the future with some reasonable probability.

Constitutional constraints on the type of legislation that may be considered eligible have the disadvantage that the general perception about an acceptable degree of directedness may change over time and depend on the particular issue being debated. The difficulty of defining what is a rule and what is not makes such changes likely and constitutionally imposed restrictions on what can be decided on by a majority too rigid as Dixit (1996) noted. It is desirable, therefore, that any mechanism governing the relative importance of directed and non-directed legislation is flexible over time.

The proposal presented in Section 3 should be seen in the light of the difficulty of designing constitutional definitions of "rules of just conduct" in Hayek's proposal and "general applicability" in Buchanan's proposal. The hierarchy of laws in conflict substitutes for the need for specific definitions of rules and general applicability. Ranking of legislation by certain criteria substitutes for definitions. Instead of constraining governments' range of decisions the proposal is expected to create political dynamics favoring rule-oriented legislation. In the following this dynamic aspect of the proposal is illustrated further.

Under current legislative procedures for dealing with conflicts among laws one principle is that the specific dominates the general. This principle seems to hold in civil law countries as well as in common law countries. The above proposal would reverse the hierarchy but only when generality of laws satisfy criteria for rules rather than just being a general statement with respect to social objectives.

Table 1 illustrates how political decisions with greater rule content may appear relative to decisions with greater directedness. The table is taken from Buchanan (1993) except that Buchanan distinguishes between policy measures with more or less generality while the table uses the term directedness in order to avoid the possible confusion related to the term generality. The intention of the table is not to define what is a rule or what is not, but it ranks policy actions in terms of the degree to which they have characteristics of rules. For example, environmental policy actions that apply equally across all industries are certainly directed towards specific social objectives but less so than a policy action that differentiates environmental standards across industries. Thus, under the hierarchy proposal presented above general environmental standards would dominate attempts by the legislative to grant favors to a specific industry by lowering its standards.

To illustrate the dynamic aspects of the proposal we consider first contract law. Assume that there is a law specifying that all verifiable, voluntarily entered contracts that are not entered under duress for any party must be enforced.<sup>8</sup> If at the same time company law specifies that companies should have only one class of voting shares, then this restriction on the contractual arrangements among shareholders in a firm violates the general rule for validity of contracts. The conflict between the laws could be resolved by making the restriction on the classes of voting shares enabling rather than mandatory. Enabling laws are by definition default options in case contracts between parties do not specify some aspects of implicit contractual relations. Another way to resolve the conflict would be to go back to the drawing board for the rule with respect to contracts' validity. For example, an exception could be made for multiparty contracts under certain conditions.

Would it not be possible to simply add the provision "unless otherwise specified" to the general rule for contractual validity? Thereby the rule would seem to become subordinated to the more directed company law even in the case when it is mandatory. Under the proposal above it would be constitutional to add such a provision but it also would reduce the degree to which the contract law satisfies rule-criteria, because it opens the way for highly directed legislation. Thus, another rule may render the provision invalid. The main point is that legislators would have to consider the possibility that now or in the future there may exist rules violating legislation directed at specific objectives and groups.

As another illustration consider restrictions on the establishment of private schools or their ability to charge for services. Such restrictions exist in many countries. However, if there is a rule specifying the freedom of business establishment the restrictions would stand in conflict with this rule. Again, the rule could be made subordinated relative to more directed laws containing restrictions on business activity, if the provision "unless the legislature decides otherwise" is added to the rule for freedom of business establishment. Even if a majority would agree on the "unless otherwise specified"-clause, it could be overruled, if a majority would agree on the provision that business establishments must not, for example, endanger health, safety, and security. Since "unless otherwise specified" allows a great deal of arbitrariness and directedness in any dimension the rule specifying conditions for restrictions on establishment of business satisfies rule-criteria to a greater degree. With the passing of the latter more conditional rule for freedom of establishment of business, the law prohibiting private schools may again contradict the more rule-oriented law on freedom of business establishment. Those wanting to prevent private schools would have to find another way. For example, a law on duty of schooling could specify that the duty is fulfilled only by attendance in specific schools. However, if a majority could instead agree that duty would be fulfilled if schools live up to quality criteria, then a government monopoly would not be upheld.

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<sup>8</sup> It is assumed that a slave contract by definition must have been entered under duress.



The rule-oriented hierarchy proposal does not directly diminish the power of legislatures to pass policy measures with great directedness with respect to specific objectives and interest groups. However, the political dynamics and the policy debate would have to change in a fundamental way because there would always be groups trying to find a majority for general rules contradicting directed measures for which a majority really does not want to pay. Furthermore, individual politicians could obtain “cover” for not trying to extract benefits for a group under a rule-oriented law. Certainly, the policy debate would have to be strongly oriented towards rules of conduct, as well as specific social objectives favored by interest groups. Such a debate could create an awareness about conflicts between attitudes towards rules and attitudes towards measures favoring groups in society.

## **7. Final Reflections**

There is a widespread concern that political representatives and the political process are viewed with disrespect, cynicism, and contempt among the citizenry. Following the diagnosis of the "bargaining democracy" such views are not necessarily the result of the wrong individuals seeking political careers. Rather, the cynicism seems to be the inevitable result of the great amount of discretionary power given to politicians. Given this power the politician must "play the game", being ready to bargain for and hand out favors to survive on the political arena, because he or she will be asked to do this by the same people who criticize the process as corrupt on other occasions.

The hierarchy-of-laws proposal presented here, stating that legislation and policy measures with stronger rule contents dominate measures more strongly directed towards specific objectives favored by identifiable groups, could be a simple way of forcing the policy debate to focus on rules and principles of conduct instead of favors to various groups. Over time, a momentum towards legislation and policy measures that truly and transparently have majority support could be created. The omnipotency of governments criticized by Hayek would not be formally reduced but a constitutional court would simply be assigned the task to determine which one of conflicting laws has the stronger characteristics of “rules of just conduct”. The constitutional change would also have to include a careful specification of criteria for rules versus “directedness” of policy measures.

There are also possible advantages in terms of social stability of the bargaining democracy. If it results in most groups becoming reasonably satisfied with the outcome of the political process, the bargaining may contribute to the general acceptance of the democratic rule. The hierarchy proposal presented here has the advantage of not making the bargaining for favors impossible but it is limited to increasing the awareness of the distinction between bargaining for favors and debating rules of just conduct, and to creating political dynamics in favor of rulemaking of legislatures.

**Table 1. Examples of degrees of rule-orientation**

<i>Greater rule orientation (weaker directedness)*</i>	<i>Less rule orientation (stronger directedness)**</i>
<p><b>Law:</b></p> <p>-equality in treatment of all persons</p>	<p>-special treatment for any group for any reason</p>
<p><b>Taxation:</b></p> <p>.broad based taxes</p> <p>-uniform rates of tax</p> <p>-absence of exemption</p> <p>-inclusion of all persons in a tax structure</p>	<p>-exclusion of voters from tax rolls</p> <p>-shelters, exemption, exclusions, special treatment of sources and uses of tax base</p> <p>-differential rates of tax among persons, forms of organization, professions, locations, products or other classificatory bases</p>
<p><b>Expenditures:</b></p> <p>-collective consumption goods with benefits coincident with whole territory of polity,</p> <p>-fiscal federalism or subsidiarity, financing by political authority coincident in inclusivity with program benefits</p> <p>-demogrants as transfer payments</p>	<p>-local public goods centrally defined</p>
<p><b>Regulation of industry:</b></p> <p>-environmental controls over whole economy</p> <p>-uniform tariffs on all imports</p> <p>-uniform subsidy for all industry</p>	<p>-differential control, by territory, by industry, by product, etc.</p> <p>-differential tariff or quota protection product by product</p> <p>-differential subsidization by product, territory or other base</p>

\* Toward Generality in Buchanan (1993)

\*\* Toward Particularity in Buchanan (1993)

Source: Buchanan (1993)

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