

(Un)Democratic Dynamics in The Bargaining Democracy

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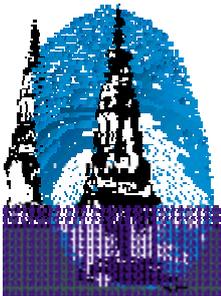
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(Un)Democratic Dynamics in the Bargaining Democracy

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(Un)Democratic Dynamics in The Bargaining Democracy*

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"Democracy is in danger when voters can vote money to themselves"
(Alexis de Toqueville, 1835-40; quoted by Werin, 1997)

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“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)

1. Introduction

The state of democracy in Western democracies has come under scrutiny in recent years. 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”, and that the possibilities of individual citizens to assert their rights against the public sector are too limited.¹ The European Convention has been assigned the task of developing a proposal for a constitution for the EU to remedy the “democratic deficit” in EU-wide decision making, and to resolve the division of powers among citizens, member states, and EU-institutions.

Political scientists and economists generally apply different criteria and analytical methods to evaluate the result of the democratic process. The former refer to criteria such as the influence of the citizenry, political legitimacy, and the equal applicability of laws, while the latter with few exceptions evaluate political processes from the point of view that individuals’ preferences should be satisfied to the greatest extent possible. The criteria applied here are essentially of the latter type with the addition that the required degree of coercion in society should be minimized. The arguments are based on Friedrich von Hayek’s analysis of the role of law and constitutions in democratic societies. In this analysis an important distinction is made between political decisions with respect to “rules of just conduct” applicable to all, and political decisions aimed at specific social objectives favored by identifiable groups in society.² Hayek’s argues that majority rule can be made to reflect the will of the people only if majority decisions are limited to “rules of just conduct” that are not aimed at particular purposes or groups, or constrained by such rules when the decisions inevitably have specific purposes or directly affect the welfare of specific groups.

A fundamental proposition in Hayek’s analysis of democratic processes is that majority rule with respect to decisions with specific purposes like public health and defence, or particular groups like the relatively poor or rich inevitably leads to results that violate the preferences of the majority. A recent example from the Swedish policy debate can be used as an illustration. The parliament decided to close a nuclear power plant in a deal between the minority social democrat government and a relatively small party favoring the closing of all nuclear power plants. The social democrats needed support for an economic package of budget cuts and tax increases. The support was obtained from the smaller party for the “price” of the decision to close a nuclear facility. The ability of the parties to cut a deal across constituencies ensured majority decisions but it is quite possible that the majority would have preferred a situation with a different economic package and continued nuclear power production. If the closing of the plant instead would require legislation specifying criteria for what constitutes dangerous production activity, or the closing would require a decision based on a legislated rule for determining whether activities are dangerous, the result of the political process may have been different.

One purpose of this paper is to analyse the possible contradiction between peoples’ preferences for rules of just conduct, and policy objectives with respect to outcomes in terms of specific social objectives. A second purpose is to discuss different constitutional proposals intended to orient the political process towards rules to an increasing extent. A third purpose is to propose a hierarchy of legislative and other political decisions to resolve inconsistencies.

¹ 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)

² In three volumes of *Law, Legislation 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.

The objective of the hierarchy is to create political dynamics with increased emphasis on decisions with respect to rules rather than specific outcomes for different groups.

Hayek's critique of current democratic processes is summarized in Section 2. 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. There is inherent dynamics in the process that leads to outcomes violating the outcome of a political process with respect to rules of conduct. Buchanan (e.g. 1993) has made similar arguments.

Modern economics analyses of political processes are reviewed in Section 3. With the exception of Buchanan few economists make the distinction between decisions with respect to rules of conduct and decisions with respect to specific objectives favored by groups. Failures in the democratic process are generally linked to assumptions about information asymmetries.

The concept of a rule of just conduct is discussed in Section 4. Hayek (1973) devotes several chapters to this concept 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.

A number of more or less far-reaching constitutional proposals aimed at improving the democratic process by orienting it more towards rules, or by limiting groups' ability to "vote favors to themselves" by forming coalitions are discussed in Section 5. A proposal for a constitutional rule for a hierarchy of political decisions based on the degree to which they have rule content is presented. In case of conflict between different laws it is currently common that specificity dominates generality. Under the proposal presented here specificity would be dominated by generality, if by generality we mean that the political decision does not aim at a specific objective favored by identifiable groups.

The political dynamics that would be the consequence of the hierarchy proposal is discussed in Section 6 with a couple of illustrations. Final reflections and summary follow in Section 7.

[A situation wherein a] "majority governmenti 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, 19 79, p. 11)

2. The Bargaining Democracy - The Hayek Critique

The expression in the title of this section is used by Hayek (1979) to describe the current political systems in the western democracies. 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) summarizes his argument with respect to the cause of the democratic failure: "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". This analysis applies to parliamentary democracies such as the Swedish one, as well as to 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 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.³ While the bargaining to create majorities occurs among individual representatives in the U.S., most of the bargaining in Sweden 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 view is the omnipotence of democratically elected governments. It has long been recognized that constitutional limits on governments' powers are required to avoid government coercion that would not occur if people were to be asked whether the coercion is acceptable to a majority. 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 is often 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. 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.

Hayek's analysis of the competition in the political market place stands in sharp contrast to these results. The ability of groups to bargain for favorable actions by government contributes to the failure of the political process, because the political issues to be decided upon depend themselves on this ability to bargain for favors. Becker's more positive results with respect to the efficiency of the political process are primarily explained by an exogenous range of issues to be resolved politically, while the lobbying effort and success of each group is proportional to the potential benefits and costs of different schemes. We return to these assumptions below.

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 and the power of issuing directives and commands have been placed in the same hands, and the term law is used both for law in its original meaning, and for directives and commands of various kinds. 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.

Parliamentary rules in a country like Sweden explicitly empower a parliamentary majority to control the executive branch, and the power of the two branches to jointly act in the special interest is nearly unlimited. The constitutionality of "laws" is not subject to tests

³ 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).

by an independent judiciary but by a parliamentary committee. Other countries have more explicit checks and balances and separation of powers. The USA in particular has independently elected executive and legislative branches of governments, and an independent constitutional court. However, Hayek points out that the American legislatures' power to serve the special interests was expanded in the 1930s and the power is no longer subject to tests by the Supreme Court.⁴

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, Hayek's analysis remains valid even in the American system, because there is no limit on the range of issues decided upon by the legislatures. In the American system as well as in parliamentary democracies the empowerment of governments to act in the special interest makes it an inherent necessity of governments to do so. Thereby, the competition for voters is won by those able to offer net benefits to a majority. The same majority may have been better off, however, had they not been able to distribute benefits to each other. One reason is that there are dead weight costs - lowering total wealth - associated with the political process, as noted by Becker (1985).

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 arena. In the political arena there is a necessity to watch the process and lobby for benefits in order to obtain a favorable "bargain". 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.

There exists a literature on "log-rolling" showing that the ability of groups or their representatives to bargain among each other for mutual support 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. The log-rolling - amounting to bargaining for mutual support - enables strength of preferences to influence the allocation of resources under government control.⁵ Aggregate wealth increasing actions that would not occur with simple majority voting are made feasible with log-rolling. Log-rolling coalitions may also vote on wealth decreasing actions, however. Nevertheless, the log-rolling literature seems to indicate that the "bargaining democracy" need not be as bad as Hayek's argument indicates.

The difference between the argument for potential wealth increasing effects of log-rolling and Hayek's critique of the bargaining democracy is that the log-rolling argument takes the potential activities of the government as given, and these activities refer to the allocation of collective goods or 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, 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

⁴ The current Supreme Court is more concerned with the separation of powers between legislatures in the states and Congress.

⁵ See Tullock (1969).

agriculture and the particular channels of this support, as well as the support of specific industries, 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, as well as Becker's 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. Therefore, the majority supported outcome will generally be different from the outcome that would be obtained under majority supported rules of conduct for governments, individuals and firms.

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. The democratic problem is to obtain a majority supported outcome consistent with majority supported rules of conduct.⁶

Would it not be possible or even likely that a party would arise in the "bargaining democracy" and gain support for a program slashing benefits and privileges across the board substituting legislation on general principles and rules of conduct for the handing out of benefits to coalitions of interest groups, if a majority actually supports such a program? It should not be ruled out that 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. Great certainty about enforcement of the general rules now and in the future is required for the individual to abide by general rules and not seeking to fulfil individual wishes through the political process. Thus, a mechanism enforcing an agreement that representatives of groups must not bargain for benefits would be required to sustain such a political equilibrium.

3. Modern Economic Analysis and the Hayek Critique

The critique of the "bargaining" democracy discussed in the previous section 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. In particular, his criteria for considering one political system superior to another do not rely on economic efficiency in the sense of Pareto optimality and wealth maximization criteria relied upon by most economists. Rather, Hayek's criteria refer to the dynamic inconsistency between preferences for rules and preferences for outcomes at a point in time. Nevertheless, his critique is in many ways supported by modern economic analyses of the political process. A brief review of such analyses follows in this section.

The individualistic utility maximizing perspective implies almost automatically that political processes are inferior to market solutions when addressing allocation problems unless there are market failures. Distributional issues, on the other hand, must be resolved through a political process.

The 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

⁶ 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 economic equilibrium condition stating that ex post outcomes are consistent with ex ante expectations. The democratic equilibrium so defined is obviously not achievable without severe constraints on the political process.

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, as Hayek argues. However, there are rarely opportunities given nor information available to 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.

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.⁷ 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' "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

⁷ Wickseil (1896) was an early proponent of the so called contractarian approach. He made the distinction between "just procedure" and "just outcomes".

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 economic frameworks described here supports important aspects of Hayek's critique of the "bargaining democracy". As noted 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. Although voters may learn about the behavior of their representatives over time and this learning influences voting and the strength of commitment of representatives to act in the voters' interest, it is in the power and interest of the representatives to limit the learning,

The most important aspect of Hayek's analysis is that the scope of government is endogenous and its dynamics depends on individuals having to form groups seeking favors of a variety of kinds in order not to lose out relatively, and on elected representatives having to offer their power to distribute favors in order to remain elected. This dynamic process does not seem to depend on information asymmetries between voters and politicians as much as on the impossibility of entering mutual commitments among representatives to use their powers to distribute favors only when the favors are the consequence of welfare increasing policies. This impossibility can be explained by the difficulty of obtaining agreement about which political actions reduce market failures and which do not. As noted, bargaining -logrolling - may be desirable when the political actions refer to the supply of collective goods, but not when groups agree on various favors to each other.⁸ Many political actions actually combine favors and corrections of actual or imagined market failures by the approaches to the corrections of the market failures. If, for example, it is accepted that agricultural support is well-motivated by national security or environmental arguments, the particular method or principle for handing out support is likely to carry favors to particular groups.

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

⁸ The problem here is similar to the problem faced by the WTO to distinguish between national policies favoring domestic industries "unfairly" from policies that correct for market failures in domestic markets.

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.

These theoretical developments support Hayek's concept of the bargaining democracy, and the argument that both parliamentary systems, and systems with a division of powers between the legislative and the executive branches of government suffer from the democratic failure described above. The exact nature of the failures and the favored groups may be different, however.

The transactions cost approach to policy making

Dixit (1996) sheds further light on the dynamics of the "bargaining democracy" by developing a transactions costs framework to the analysis of economic policy making. This transactions costs approach to politics is an adaptation of transactions costs economics. This branch of economics focuses on explaining the institutions and the organizations of a market economy by considering various costs of contracting, enforcement, information gathering, etc. associated with market transactions, as well as costs associated with non-market transactions. Dixit's objective is to employ a similar apparatus of concepts and tools to explain and, to some extent, to evaluate political processes. A simple illustration of the role of transactions costs is that those individuals that can form lobby groups with relatively low costs tend to be favored by the political process. The low costs of forming groups may be explained by, for example, incentive compatibility, or the ease with which individuals' interest can be identified and monitored within a group. Information costs, and losses caused by lack of information as described by the principal-agents models are also transactions costs.

The transactions costs approach to politics like the same approach to economics leads to an emphasis on the dynamics of political decision making, and therefore on the rules surrounding the political processes. The emphasis on dynamics in the transactions costs approach implies that efficiency criteria differ from conventional economic criteria. In transactions costs economics the relative economic efficiency of different institutional setups is evaluated, for example, by the total output minus transactions costs over some time horizon. The longer time horizon is necessary because different institutions adapt to changing circumstances to different degrees. A particular institutional set up may maximize efficiency at a particular time but unless it changes to circumstances it may contribute to increasing losses over time. Dixit (p, 60) argues that political institutions as rules for the political process must be evaluated similarly taking the adaptation over time into consideration.

One potentially interesting application of transactions cost politics is a comparison of the political dynamics in a representative, parliamentary democracy wherein political parties are at the core of the process, and a democracy of the American type where representatives as individuals have more influence on political actions. As noted, Hayek argues that the distinction is relatively unimportant as long as interest groups and their representatives are able to vote favors to themselves. There are certainly differences in the nature of transactions costs, however. One hypothesis is that in the party system associated with parliamentary democracies with proportional representation, the "bargaining costs" among groups within a party are lower than the bargaining costs across parties. In the more individualistic system the bargaining costs are more equally spread across the representatives. Thus, the majority on a range of issues within the party system may consist of more like-minded people as long as the same party stays in power. In the individualistic system the coalitions are more likely to vary among different issues and the costs of gathering a majority for a bargain are likely to be higher. If the political parties disintegrate into smaller groups then the systems become more similar.

A second reason why the party dominated system may be more "action-oriented" is that it may be sufficient to gather a majority within a party for the whole party to push an action. Thus, in principle a bargain among politicians representing 25 plus percent of the vote is sufficient to gather a parliamentary majority. There are naturally transactions costs associated with such actions, because party loyalty could become strained. Furthermore, if the same minority pushes its will a number of times the party could lose voters in the next election. However, fluctuating minorities distributing the favors within a majority party or a coalition may successfully push for favorable actions over several elections.

In conclusion, modern economic analysis of political processes is developing rapidly. Much research supports the Hayek critique of the bargaining democracy. In particular, the case for constitutional rules governing the political process is strong in modern economic analysis. Furthermore, the transactions costs' framework to politics lead to an emphasis on the dynamics of political processes, and an dynamic criteria for evaluation of different political institutions. Hayeks distinction between policy actions with respect to rules, and actions with respect to outcomes for particular groups is particularly fruitful in a dynamic context.

"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)

4. Politics of rules and outcomes

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.

All democracies have gone far in the direction described by Hayek (1979) where the legislative assembly does not limit itself to determine law in the traditional sense of rules of conduct for the interaction among government bodies, firms, and individuals. In most parliamentary democracies the constitution allows a vote by the majority of representatives on almost any issue and such a majority can erode individual decision power on almost any issue. It can also limit or expand the domain of the judiciary relative to the public sector administration.

Hayek (1979) and Brennan and Buchanan (1985) argue that governments should focus on the rules of conduct to the greatest extent possible as opposed to "making law" in the form of directives designed to influence the outcome of economic processes in favor of particular individuals and groups. Constitutional reform's shifting the focus of the political process to the making of rules to an increasing degree would serve the democratic ideal according to these writers. In order to discuss this issue further it is desirable to have a definition of a rule of conduct - a law in the traditional sense.

Many social objectives can be reached by means of either directives or rules. For example, health standards for meat could be issued as directives. Alternatively, rules for firms' liability in case of harm to their customers could serve the purposes of health policy.

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. 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 criteria 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 may be 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 economies. 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.

Transactions costs arguments for rules

Linking this discussion to the ideas of Dixit's transactions cost framework for politics there is little doubt that there are transactions costs associated with the determination of what a rule is. Transactions costs in the political process of finding majority support for a rule may be relatively low, however. 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 outcomes. For example, in the health standards example above agreement on liability rules maybe relatively easy to reach while opinions about exact standards may vary. Votes on exact standards can also be used to favor particular producers. For example, 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) discusses pros and cons of rules within the transactions costs framework. Rules serve 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. Loop-holes are a source of arbitrariness in the implementation of a rule. One way to address this problem discussed in Macey (1993) and Wihlborg (1997) is to make rules "enabling" as opposed, to mandatory". This distinction applies when law has the nature of standardized contracts. Company law specifying corporate charters, and much labor law belongs to this type of law.⁹ If rules are enabling the rule stated in law can be changed if both parties agree to

⁹ Posner () distinguishes among law of contracts, law of property, and law of torts. The distinction between enabling and mandatory law applies on law of contracts.

a different conditionality than the law states. Essentially, enabling law extends the principle of freedom of contracting to cases when contractual terms are prespecified in law.¹⁰

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.

Rules for the government and the public sector

Governments cannot limit themselves to determine rules of conduct. By popular consent they 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.

Laws for the public sector's administration is an important aspect of the relationship between citizens and the state. The laws for the administration of the social welfare system, environmental policy authorities, the school system, the health system, immigration authorities, etc. give enormous powers to individuals in the public sector administration in many countries. If only general objectives are stated in law, then administrators are given the leeway to interpret how the laws apply to particular individuals. These interpretations are often not under the domain of the judicial system. Thereby the predictability of the application of various laws suffers. The lack of legal safeguards against, public sector abuse of powers in Sweden was one of the negative aspects of Swedish democracy according to political scientists referred to in the Introduction. The institution of an "ombudsman" substitutes to an extent for legal safeguards against government coercion, although the power of the ombudsman lies primarily in the ability to publicize information about abuse. It is perhaps not surprising that the variety of "ombudsmen" is greater in Sweden, where the word originates -- with the substantial potential for abuse of power -- than in other democracies.

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

5. 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

¹⁰ See Wihlbørg (1997).

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 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).¹

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.

A proposal for a hierarchy of laws.

There are alternatives to the Hayek-Buchanan proposals that may achieve some of their objectives but subject to less criticism that they are beyond constraints on today's politics. Proposals for qualified majorities and stronger separation of powers could be viable alternatives.

Without offering a thorough analysis the following proposal is offered as a basis for further analysis and discussion: Establish a general constitutional principle for a hierarchy of legislative action such that legislation with stronger rule-characteristics will dominate and overrule conflicting legislation and directives with weaker characteristics of rules. A constitutional court with political independence would be charged with the task of evaluating the degree, to which legislation satisfies characteristics of rules. These characteristics would include "lack of directedness" and "lack of arbitrariness" as discussed above. One advantage relative to Hayek's and Buchanan's proposals is that a constitutional court must 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.

Under this proposal, groups would be able to bargain for government resources but if another majority could vote for laws with less directedness in conflict with a part of the bargain, then this part of the bargain would be invalidated. 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 by 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.

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 may 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 little measures without transparency would be discouraged.

6. A Momentum Towards Rules -- Illustrations

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 when generality of laws satisfy criteria for rules rather than just being a general statement with respect to social objectives. The main purpose of the proposal to establish a rule dominated hierarchy of laws 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.

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.¹¹ 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 almost automatically be 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 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.

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

¹¹ It is assumed that a slave contract by definition must have been entered under duress.

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 Hayek's 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.

Table 1. Examples of rules of different degrees

<i>Greater rule content (weaker directedness)*</i>	<i>Less rule content (stronger directedness)**</i>
<p>Law:</p> <p>-equality in treatment of all persons</p>	<p>-special treatment for any group for any reason</p>
<p>Taxation:</p> <p>.broad based taxes -uniform rates of tax -absence of exemption -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 -differential rates of tax among persons, forms of organization, professions, locations, products or other classificatory bases</p>
<p>Expenditures:</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>Regulation of industry:</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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