

Chapter 10: An Introduction to Constitutional Political Economy

I. Introduction Constitutional Political Economy

Constitutional political economy is a field that can be thought of as part of public choice or vice versa. It is the study of the origins, evolution, and effects of institutions, especially political institutions. Its ideas can be extended to include areas of ethics, social norms, and economic institutions as well.

The sense in which it can be regarded as a subfield of public choice is that it is one of the three major strands of research that emerged from researchers in public choice. James Buchanan wrote many of CPE's foundational books and papers, the most important of which is the *Calculus of Consent* (1962) written with Gordon Tullock. That book used rational choice models and early public choice ideas to analyze institutions like those used in the United States and attempted to determine their impact on public policies and the reasons why individuals might prefer those political institutions to others if they did not know exactly where they would be in the society that followed.

The sense in which public choice can be regarded as a subfield of constitutional political economy is that constitutional rules, laws, and regulations determine the “rules of the game” through which public choices are made. These include the voting rules, the organization of government (president and bicameral legislature), election cycle, and constraints on the kinds of laws that can be passed (bill of rights and taking clauses). In cases in which a new government is formed whole cloth, the first step is often a constitutional convention in which decision rules are worked out and formally adopted. In cases in which governments gradually emerge through a series of formal and informal bargains, many of those bargains involve decision making procedures—e.g. how one chooses public policies, which is to say constitutional reforms.

The effects of constitutions on public policy emerge through effects that a constitution's standing procedures and constraints have on the public policies chosen. The extent to which liberal democracies, for example, tend to promote economic development arises through the

policies actually chosen rather than because of democracy itself. (Some ideas make both more likely, but these are beyond the scope of this lecture.)

This lecture has two main parts, first a discussion of the effects of political institutions on public policies and thereby on the real economy and citizen interests. The second part provides an overview of the problem of constitutional design, where constitutions come from, how they are amended, how they tend to evolve.

II. The Effects of Constitutional Designs on Public Policy

It turns out that the previous three or four lectures have already begun to describe how political institutions affect public policies. The use of majority rule tends to make median voter interests important. Rules that affect the rewards and risks of rent seeking and bribery affect the extent and kind of interest groups that form and the methods of lobbying that tend to be most effective. Differences between dictatorships and democracies also affect policies, because their pivotal decisionmakers differ and their aims and powers differ. Dictators may have ideological agendas (supreme values) or they may have economic agendas (revenue and rent-extraction). Median voters may have similar interests but they are not themselves in positions as residual claimants and moreover have interests in services that do not necessarily increase the tax base.

In divided systems of governance such as those that can be characterized with the king and council model, compromises between a king and elected parliament generate policies. And these are likely to lie along a continuum between those most preferred by authoritarian and democratic regimes.

Other features also matter as developed in this section of lecture 11. It turns out, for example, that different forms of majority rule have somewhat different implications for public policy. Perrson and Tabellini (2000) argue that Proportional and single member district systems tend to make more or less use of general versus targeted programs.

There are also differences between de jure and de facto constitutions (e.g. between those written down and the actual rules that characterize policy making). That is to say, some

written constitutions more firmly bind some governments than others. These may reflect differences in constitutional design, but also differences in criminal law, the judiciary, and culture that affect the extent to which laws are followed and enforced.

Governments may also be more or less decentralized which implies that local services will be more or less varied and under different pressures to be efficient. Sorting allows differences in ideology and ethnic preferences to generate different kinds of local governments and their associated services. However, decentralization also may leave regional and national public goods and externality problems unsolved. Or, if permitted, it may cause new levels of government to be formed as treaties among state governments that address such problems.

The remainder of this section explores some of the effects of constitutional designs on public policies. The following section explores the origins and evolutions of constitutions.

Proportional and First-Past-the-Post Elections

Proportional representation systems were adopted by several countries in the period just before World War II as parts of constitutional bargains that adopted universal or near universal male suffrage in Northern Europe. These systems are based on multiple member districts in which seats in parties are assigned to parties based on the proportion of votes received subject to a minimum threshold for seats. The parties have lists of candidates arranged in an order and the top candidates on the list “win” seats in parliaments. (Some systems allow voters to vote for persons further down the list, which makes the ordering partly a function of individual candidate votes.) Some countries have several such districts and others have just one for the entire nation. The result tends to be a parliament with many parties represented, often 4, 5, or more.

First-past-the-post electoral systems are older. They divide a country into single-member districts, with one district for every member of parliament chosen in this way. The districts are generally partly based on population, partly on geography, and politics. The candidate that represents a district is the one that receives the most votes in an election. (In some cases, run offs are required among the two highest vote recipients, so that the winner receives a majority of the votes.) The geographical nature of the districts allows those

choosing the boundaries to bias the system in favor of particular groups or parties, through a process sometimes termed “gerrymandering.” (The term “gerrymandering” was named after a strange “salamander” shaped district in Massachusetts created in 1812 by governor Gerry.) First-past-the-post systems tend to have fewer parties in the legislature than PR systems, with 2 or 3 being the norm.

These short descriptions are sufficient to highlight a few significant differences in the two majoritarian electoral systems for selecting members of the legislature or parliament. We next briefly analyze how elections and electoral competition affect incentives for party platforms and subsequent coalitions and policymaking in legislatures.

First, what might be called party elites are more important in proportional rule systems, because they select their candidates and order them on the list. This allows a party’s policy experts to hold seats in parliament even if they are not particularly good at giving speeches or campaigning for office. The persons gaining high positions on party lists tend to be older experienced men and women who have risen through the party ranks. They tend to be loyal and capable. Although parties are also important in first past the post systems, they are less so than in PR systems, especially in cases in which candidates are selected through primaries. In such cases, candidates nominate themselves and are selected through plurality elections. This makes candidate characteristics (charisma, speaking ability, fund raising ability, etc.) at least as important as party affiliation. Gerrymandering, however, often creates “safe seats” for some candidates, and these may resemble in some respects the safe spots of candidates placed high on their party’s lists.

A second difference concerns the usefulness of general versus targeted government programs. In first past the post systems targeted programs can be used to help incumbents (those previously elected) by demonstrating that they can “bring home the bacon.” Such programs may be used to try to influence close elections by the party that dominates the legislature. Such programs would not help a party under proportional representation. Instead the party that controls the legislature in PR systems is normally the dominant member of a majority coalition. That party also usually controls the executive, because most PR systems

are parliamentary rather than presidential systems. Parties that hope to be tasked with “forming a government” (e.g. selecting the next prime minister) can tailor nationwide platforms and programs to favor persons who might be induced to vote for their party lists in the next election. This provides a possible explanation for the broader safety net programs of Scandinavia, who use proportional representation systems relative to countries that use first-past-the-post systems as in the United States. See, for example, Persson and Tabellini (1999, 2004).

This is not the only relevant difference, but it is one. There are, for example, ideological and historical differences that affect patterns of voting and preferences over parties and public policies.

Presidential and Parliamentary Systems

Most governments make use of the king and council template, which means that policy making authority is divided between a king (prime minister or president) and a council (parliament or legislature). The division of authority between the king and council varies widely with some executive branches (kings) having substantial policy making authority and some parliaments relatively little authority, and vice versa. Within Western democracies, there are somewhat more parliamentary systems than presidential systems, although presidential systems are fairly common in South America and Africa. Within prime ministerial systems, the executive is elected by the parliament and normally the prime minister is delegated broad authority over “ordinary” regulations and foreign policy. The parliament, however, can remove the prime minister through votes of “no confidence” which often also calls for new elections. Presidents, in contrast, are independently elected and hold their positions of authority because of direct decisions by voters.

The balance of authority in presidential systems is normally defined by the constitution rather than parliamentary decisions and there is always some ambiguity at the margin about exactly where the President’s authority begins and the parliament/legislature ends. Since a different party may control the legislature and parliament, there are often disagreements

about what good policy is and the extent to which the president can pursue his or her concept of good policy without explicit enabling legislation adopted by the legislature.

There are often ways for a legislature to remove a president from office, as in the US through its impeachment process, but such removals are uncommon and reserved for a type of “emergency,” in the U.S. high crimes and misdemeanors. If such removals became routine, the government would become semi-prime-ministerial, rather than presidential in that a president could remain in authority only with the approval of the legislature/parliament. The U. S. system is best explained as a compromise between the two systems. However, that is not because presidents are elected by electors rather than voters, but because of the process through which a president can be removed. Presidents cannot continue to serve unless they retain significant support within the Senate.

The relationship between parliament and the executive generates different incentives for the executive. A prime minister is normally the leader of the party that controls (has a majority or is the decisive member of a majority coalition in parliament) and thus is well connected to the members of the majority in the parliament. They are unlikely to disagree significantly over policies. In a presidential system the president may have quite different interest in policy and in the extent to which presidents are independent to implement their policies. This produces quite a bit more potential for conflict than in prime ministerial systems of governance, but also more compromises across party agendas.

Most PR systems of elections are parts of parliamentary systems of governments rather than presidential systems. Many first past the post systems are also prime ministerial, (as with that of the United Kingdom) but others are presidential.

Empirical Evidence of the Effects of Different Democratic Institutions

The public economics strand of CPE research attempts to determine how differences in democratic institutional designs affect the public policies chosen. It has been an active area of research in the 21st century after getting off to a somewhat slow start in the late eighties (Grier and Tullock 1989) and early 1990s (Congleton, 1992). Important international papers include Persson and Tabellini (1994), Knack and Keefer (1995) and Persson, Roland, and

Tabellini (2000). All four of these papers found that “institutions matter” and did so more or less in the manner that the above analysis predicted. Federalism was also found to affect the kinds of policies adopted by governments as with the relative size of social insurance programs (Congleton and Bose, 2010, Batinti and Congleton, 2018).

The development/CPE literature, in contrast, attempted to determine whether democracies are richer or grow faster than authoritarian regimes. Empirical work was somewhat mixed in this respect, although the old democracies of the West tend to have higher average incomes but somewhat slower growth rates than many, but not all autocracies. A very useful meta study of this enormous body of empirical research undertaken by Doucouliagos and Ulubaşoğlu (2008) shows that democracies tend to be associated with higher income and growth rates worldwide.

Another somewhat related strand of research concerned the effects of supreme courts on growth rates initiated by Feld and Voigt (2003, 2015), who attempt to distinguish among countries by the independence of their highest courts, but do so based on de facto rather than de jure independence of the courts. Generally, countries with the most independent supreme courts grow faster and higher incomes than those whose highest courts are the least independent (measured as de facto independence, rather than de jure independence). This evidently has to do with more secure property rights and less corruption—of course—rather than direct effects of courts on growth rates.

The bulk of CPE research in the 21st century has been statistical and historical rather than theoretical—and much of that work essentially unconnected to economic modes of thought.

III. CPE and the Origins and Evolution of Constitutional Designs

For most purposes, political institutions within “stable” democracies can be assumed constant during periods of 10 or 20 years, but constitutional designs do change through time as they are reinterpreted, amended, or overthrown. In the short and medium term, the “rules for making rules” or “the rules of the game,” can be taken as given and ignored when doing a study within a government with a stable governmental architecture. However, within countries undergoing civil warfare, revolution, or simply radical reforms, constitutional

changes cannot be safely ignored. Changes in institutions will change the responsiveness of governments to both electoral and interest group pressures and thereby affect the path of public policy.

The variation in constitutional designs also has to be taken into account in international studies. In statistical studies, this usually requires more than a simple “fixed-effect” variable because the effects of institutions on public policies are often complex, often non-linear and driven partly by unexpected events. For example, an unexpected increase in median income may affect median voter demands for different services differently (because of differences in income elasticities) and the extent to which those revised demands affect policies will vary with the details of a nation’s political institutions (frequency of elections, extent of competition, nature of elections, and organization of government, etc.). In such cases, institutions matter, and need to be accounted for even in relatively short-term pooled studies of policies adopted among various nations. In the longer term, national institutions will also change and these too will affect the trajectory of public policy.

Because of such effects, the origin and evolution of a nation’s political institutions are also relevant determinants of public policy and so an “edge” topic in public economics. (It is more central to constitutional political economy, and various subfields in political science and history.) We have already developed some ideas about the origin of state power earlier in the course. We reviewed models grounded in conquest (stationary bandit) and models grounded in solving social dilemmas (the productive state). These origins have different implications for the constitutional designs and constitutional evolution.

In both cases, the first constitutions are chosen with the interests of what I termed “formeteurs” in mind. In an authoritarian state, the formeteur(s) is the leader(s) of the bandits that take over a territory. Such formeteurs are interested in maintaining control and extracting income and wealth from the territories governed—except in cases in which they are motivated by an ideology of some kind, in which case the imposition of laws grounded in their ideology would also be an objective. Their constitutions tend to be of the “top down” variety with authoritarian(s) maintaining most control, but sharing authority when it

increases rates of extraction, security, or advances ideological interests. Such governments are often divided and may include council(s) of advisors and/or important interest groups.

In contrast the formeteurs of productive states are normally political entrepreneurs who attempt to form an organization to solve specific public goods and externality problems. They attempt to focus the organization created on the problems at hand and also to prevent the organization created from becoming stationary bandits. They do so by constraining the organization's domain of policy and the powers delegated to them and through formal decision making procedures. The organizations created may address simple public goods problems—the draining of a marshland or channelizing of a body of water—or may be tasked with more complex problems such as assuring peace in the community, which requires both a law enforcement system and community defense. The end, however, is not to advance the interests of the government created but the shared interests in the community or at least among the formeteurs.

In both cases the ends—the interests of those creating the government—determine much about the nature of the standing procedures adopted. The formeteurs of extractive states will retain broad discretion over policies and will shed or share that discretion only when it advances their aims—which in the case of pragmatists can be summarized roughly as wealth and deference. The formeteurs of productive states also attempt to retain authority as with requisite tribe and village meetings for important decisions. As either sort of government increases in size and scope, decision making procedures within both organizations tend to be formalized, authorities delegated, and various specializations developed.

It is arguably the case that the formeteurs of the productive states have the more difficult organizational design problem, inasmuch as government officials will broadly share interests in acquiring more discretion over policy—e.g. more power—and higher incomes for themselves and their families. The latter produces an evolutionary track away from productive states and toward authoritarian ones as successive generations of “officials” gain more and more powers—sometimes as a thank you for exceptional service to the community and others through acquiescence to marginal “power grabs” by government

officials. Without sophisticated governmental designs and supporting norms, productive states tend to evolve toward authoritarian extractive state over the course of time, without the need for violence of conquest.¹

Divisions of Authority

In both cases, it is easy to imagine that the first governments were “undivided” in the sense that a single individual or small group made all policy decisions in an extractive state and a tribal or village made all decisions in the case of a productive state. However, the process of dividing up authority would tend to emerge in authoritarian states as soon as advantages from specialization or negotiations with one’s neighbors emerged. The authoritarian cannot literally do everything 24-7, but has to delegate some decisionmaking authority to others in order to maximize his or her wealth and quality of life. As such delegations take place, meetings of the ruler and specialists or advisors are likely to be held to make major decisions.

Within a tribal or village government, delegation also tends to take place insofar as continuous management of village projects cannot literally be undertaken by all members of a community. Thus, a manager might be tasked with day to day decision making authority for a given project or group of projects. The manager(s) may be required to meet with the tribe or village regularly to inform it about progress and/or for feedback from the tribe or village about what is going well or poorly.

Notice that in both cases, something like a “king and council” template for governance tends to emerge as authority is divided up between the formateurs and their organizations. On one side tends to be an executive and on the other a group: village and town manager in the case of productive states, ruler and council of advisors (or critical supporters) in the case of authoritarian regimes.

¹ The city states of medieval Europe often retained their productive characters for their formateurs, who were often relatively wealthy merchants as with the Hansa league in northern Europe. Other free cities in Europe were created by local extractive rulers with the aim of stimulating economic development and both their tax base and opportunities to benefit from foreign products and skilled craftsmen. Both tended to have somewhat representative systems of governance dominated by relatively wealthy and well organized members of their communities.

Although the “architecture” of governance is similar in both cases, the division of authority between the “branches” of government is very different. In the productive state, the “council” (citizenry or at least a significant fraction of it), holds most of the authority. In the extractive state, the “king” holds most of the authority.

Given a stable division of authority—which might emerge gradually as customs within government emerge—possibilities for constitutional exchange (e.g. changes in the distribution of authority) may take place on somewhat extraordinary occasions. On ordinary occasions, the balance of authority and decisionmaking processes of governments are taken to be given—simply facts of life that determine public policies in the communities or territories of interest.

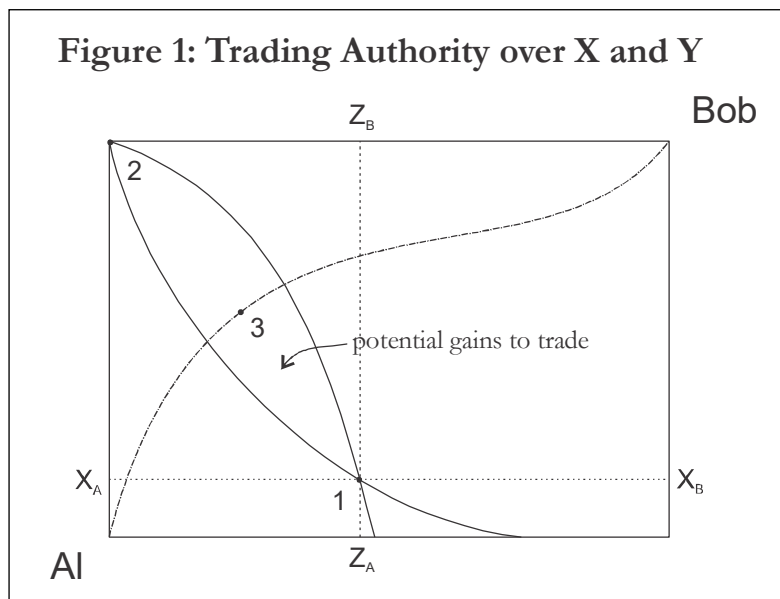
Constitutional Exchange and Reform

Given a stable process of making decisions and domain of authority, it can be said that a constitutional government exists. This does not necessarily mean that there is a written document that explains the core procedures, architecture, and constraints of governance, but it implies that rules—often customary—describing those details all exist and are understood by those holding positions in the governing organization.

Given a stable pattern of governance, opportunities for what I have termed constitutional exchange (Congleton 2011a) can arise when the persons in authority change or when internal or external circumstances change. The latter may include ideological and technological “shocks” or new trends. They may also be induced by interest groups that are able to sustain successful persuasive campaigns and/or revolutionary threats.

The idea that shifts of authority can be voluntary—although not always Pareto superior moves—is counter intuitive to many persons. The following excerpt from Congleton (2013) illustrates and describes how this can happen. The piece also provides statistical evidence of the existence of divided governance and of “typical” governing architectures in today’s world.

When economists teach their students about gains to trade in an intermediate microeconomics or advanced principles of economics class, they often sketch an Edgeworth box on “the board,” similar to that in figure 1. Edgeworth’s clever geometry shows why potential gains from trade may exist and that they may be realized in a variety of ways by shifting goods among two potential traders. The box demonstrates that shifting goods among persons can actually make all parties better off—a counterintuitive proposition for most students. Both persons are better off at position 3 than at positions 1 or 2.



For the present analysis, it is important to note that what is traded is *not actually goods, but authority over goods*. Exchange requires a voluntary transfer of authority over goods and/or services from one party to another. If Alice simply took goods from Bob and gave him some of her own, this would not be an exchange unless Bob agreed to shift authority over his goods to Alice. If he did not, he could veto such transfers *even if such a transfer made him better off*. Moreover, both civil law and the courts would support his veto even in such cases. Trade occurs only when all parties agree to particular shifts of authority over goods from themselves to other persons. Without such a transfer of authority, trade does not take place, although theft and redistribution may.

This implies that the usual way of labeling the diagram is a bit misleading. The horizontal and vertical axes are normally said to represent quantities of goods (and/or services). However, what is actually characterized is the *distribution of authority* over the existing goods and services in the economy of interest (e.g., of ownership rights). What points inside an Edgeworth box actually characterize is the distribution of authority over a predetermined quantity of two goods.

For example, if X in the diagram above is tomatoes, Z is peppers, and the two private garden outputs can be represented by the endowment combination labeled 1, with each gardener having complete authority of his or her own production, gains to trade exist. These gains can be realized by shifting some of the authority that each initially has over their own homegrown produce to the other. This shift occurs only for the subset of the tomatoes and peppers traded. Technically, what is actually exchanged is not the produce per se, but rather (legitimate) *authority over part of their garden's output*.

The exchange may be expressed in terms of the number of peppers that Bob gives to Alice in exchange for a number of tomatoes. However, only the initial distribution of authority is changed, the total number of peppers and tomatoes is unaffected.

Note that voluntary exchange requires Alice and Bob to have two levels of authority, the first over the goods themselves—they may use them more or less as they see fit—and the second over the assignment of those rights. With respect to the latter, they must have the authority to shift their authority over their goods and/or services from themselves to other persons. And normally, as owners, they will also have the authority to propose particular terms of trade and to reject shifts of their own initial authority. Because voluntary exchange requires participants with both veto and agenda-setting power, the act of trade may be said to require the existence of a “divided government,” although this is not true for acts of taking or theft.

One might ask what the above legalistic analysis of exchange has to do with the topic of this section of the lecture, namely the concepts of divided governance and separation of powers as applied to politics?

There are several parts to the answer, but the four main ones should be clear from the above. First, organizations—even temporary organizations such as those involving two traders—very often exhibit divided authority. Second, authority is inherently transferable. Third, transfers of authority may be voluntarily undertaken. Whenever particular transfers exist that can make all of the parties with veto authority over the exchange better off, the parties will attempt to reassign authority to realize those gains. Together these three imply the fourth: *there can be, and are likely to be, markets for power (authority)*. Indeed, essentially all retail, wholesale, stock, insurance, and futures markets are settings in which authority over goods and services is traded among participants.

Using Edgeworth boxes to analyze markets for political as opposed to economic authority “simply” requires reinterpreting the axes. The horizontal axis might, for example, be reinterpreted as the degree of budget authority over education and the vertical axis as the degree of budget authority over healthcare services. The two persons represented may be pivotal members of a central and local government. The indifference curves may represent the preferences of pivotal decision makers over those areas of authority (which are partly institutionally induced by various rules and regulations). Insofar as the indifference curves capture essential aspects of the goals of the relevant decision makers, the logic of the Edgeworth box is unaffected. There may be gains to trade in political authority between Alice and Bob. Power may grow out of the barrel of a gun, as claimed by Mao Zedong, but once possessed, gains to trade occasionally exist and can be realized through entirely voluntary shifts of authority from one locus of authority to another.

Note that such gains to trade do not require an initial “mixed government” in which all authority is initially shared among several officeholders or policy-making bodies. Gains to trade can exist when there is initially a complete separation of power as well as with mixed assignments. In the illustration, gains exist at assignment 2 where a complete separation of authority exists. Note that both pivotal officeholders prefer distribution 3 to distribution 2. Thus, even with an initially complete separation of authority, gains to trade may exist, and

authority may be shifted among the persons or agencies of interest in a manner that “undermines” the initial separation of authority.²

Such constitutional exchanges are common in all organizations with governments whose constitutions include methods through which policy-making authority can be reassigned. Such procedures can be regarded as amendment procedures, although they may not always be called that within the organization itself.

Markets for power, for example, clearly exist within modern corporations. Senior management’s influence over “their” corporation’s future policy decisions (products, production process, distribution network, and employee compensation schemes) is clearly divided. Senior managers share policymaking authority with each other and with their board of directors, their shareholders, and other financiers. Authority might initially be held entirely by an organization’s formateurs, who may subsequently decide to “go public.” This act involves trading authority from themselves to others in exchange for capital or other goods and services. Such trades of authority resemble those that begin at the endowment labeled 2 in figure 1. Individual stockholders may increase their authority by purchasing it (shares) from other stockholders or paying a higher price for it in the initial offering. When there are large numbers of shareholders, even a modest increase in percentage of all shares held can significantly increase one’s influence over policies.³

²Congleton (2011a: chs. 5–6) provides a more technical analysis of bargaining over veto and agenda control in a setting of exogenous shocks—an analysis that persons who are skeptical of the Edgeworth box representation of constitutional exchange should consult. It shows how changes in circumstances (initial conditions and/or probability distributions) may change policies and also interests in bargaining over policy-making authority.

³In the two-person case, this analogy is less perfect, because whichever person has more than half the shares would control a company if it used majority rule. Thus, only four assignments of authority are possible in two firms in which shares are divided between two persons, and only two of that involve sharing overall authority. The analytics of divided authority can be very complex. See Congleton (2011, ch. 5) for an effort to characterize how assignments of veto power and agenda control might be exchanged.

IV. Conclusions

The relevance of constitutional political economy for public economics is fourfold. (1) Constitutions determine the procedures through which public policies are determined. These procedures have significant effects on the kinds of policies adopted. This is true of minor variations among state and local governments (Crain and Miller, 1989, Kirchgässner and Pommerehne, 1996, Frey and Stutzer, 2000) and also among democratic nation states (Persson, Roland, and Tabellini 2000, Congleton and Bose, 2010). (2) Differences in policies in turn affect economic outcomes both on the micro economic and macro economic levels (Grier and Tullock, 1989, Knack and Keefer, 1995, Doucouliagos and Ulubaşoğlu, 2008). (3) It is ultimately policies that most directly affect economic outcomes (Gwartney, Lawson, and Holcombe, 2000, De Haan and Sturm, 2003) although the effects of policies vary among countries—generally being more effective in democracies (Stroup 2007, Saha, Gounder, and Su, 2009). (4) Changes in constitutions, thus, become an important factor in positive public economics, albeit one, like culture, that is at the edge of public economics.⁴

V. Suggested Readings

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⁴ A number of very interesting studies of the effect of trust on public policies and growth rates have been undertaken over the past 15-20 years that suggest that this social phenomena is highly correlated with attractive public policies and public policy outcomes. See, for example, Knack and Zak, 2003, Berggren and Jordahl, 2006, or Bjornskov, 2010.

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