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Conceptual Foundations

Before addressing the core issues of this primer, a number of preliminaries need to be dealt with. These include the following:

- (1) showing that constitutional political economy (CPE) is part of a broader research program, namely, the New Institutional Economics (NIE);
- (2) defining some key terms;
- (3) summarizing the various concepts of the constitution that have been used;
- (4) discussing some of the methodological challenges constitutional economics faces;
- (5) presenting some of the tools that are used to gain insights;
- (6) briefly discussing the most relevant outcome variables; and
- (7) addressing several issues in measuring constitutional as well as other variables.

1.1 Constitutional Political Economy As Part of the New Institutional Economics

Scholars working in the NIE analyze (i) the (economic) effects of alternative institutions and (ii) the determinants of institutional change (see, e.g., North 1981, 1990; Voigt 2019 is an introductory textbook for the NIE). Institutions can be defined as commonly known rules used to structure recurrent interaction situations with a sanctioning mechanism that can be employed in cases of noncompliance. North (1990) distinguished between formal and informal institutions, referring to the formality of the rule as the distinguishing criterion. Voigt and Kiwit (1998) propose distinguishing between external and internal institutions. The distinction between external and internal institutions lies in who does the sanctioning. The state carries out the sanctioning for external institutions, whereas internal institutions are based on customary practices and the sanctioning is done by the members of the society. As long as constitutional rules are viewed as a specific kind of institution, the NIE can be interpreted as the more inclusive research program. Surveys or textbooks on the NIE might reasonably be expected to include the economics of constitutions, but they usually do not.

It is argued here that constitutional political economy could profit immensely from positioning itself within the broader NIE. The normative branch of constitutional economics has been dominated by contractarian approaches (e.g., Buchanan 1975) in

1.2 Definitions

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which a very broad capacity to deliberately set and modify constitutional rules is at least implicitly assumed. Additionally, it is often assumed that the actors choosing the constitution have at their disposal complete and perfect knowledge concerning the consequences of alternative constitutional arrangements. These two assumptions are neither realistic nor adequate for understanding how constitutions actually evolve. If these assumptions are abandoned, an important issue can be dealt with explicitly, namely that the enforcement of constitutional rules is precarious and depends on a number of conditions that ought to be identified. Actual enforcement could, for example, depend on “pre-constitutional” internal institutions. These internal institutions could thus constitute hard constraints on the enforceability of constitutional rules.

1.2 Definitions

Economists have analyzed constitutions from many different angles, including, but certainly not limited to, as a social contract, as an incomplete contract, as a principal–agent relationship, as a precommitment device, as the result of cultural evolution, and as a bundle of conventions. In this primer, I draw on results from different perspectives, so it seems appropriate to choose a wide definition of the term “constitution.”

An early definition within the research program of constitutional economics was provided by Buchanan and Tullock (1962: vii): “We shall mean by this term (constitution) a set of rules that is agreed upon in advance and within which subsequent action will be conducted.” This is a very broad definition. I propose to distinguish between three areas to which it can, in principle, be applied:

- (1) constraints that an individual imposes on herself;
- (2) constraints that individuals impose on each other in social settings that can range from family constitutions to constitutions of soccer clubs and firms; and
- (3) constraints that are imposed on the agents representing the state.

In this primer, we are exclusively concerned with the last approach.

Constitutions are concerned with procedures for the production of public goods. By writing and adopting constitutions, societies are not deciding with any meaningful detail on what sort of public goods they want to provide for themselves.¹ Rather, constitutions contain provisions that are intended to be used in making those decisions. They, therefore, constrain the representatives of society in the ways they choose what public goods should be produced. At the same time, they enable

¹ Note that, literally, it is always individuals – never societies at large – who choose. We, thus, are not departing from methodological individualism but simply saving space when we write that “societies choose.”

politicians to make choices. If one is interested in analyzing a society's choice of a constitution, one is really interested in analyzing a meta-choice; that is, how a society chooses (on the constitutional level) how to choose later on (on the postconstitutional one). Or, in the words of Peter Ordeshook (1993: 231f.): "A constitution is not a piece of legislation; it is the mechanism people use to guide the formulation of legislation and law." A constitution can be defined as a system of rules used for the provision of public goods within the collectivity called the state. Constitutions will regularly

- (1) define the organs that make up the state;
- (2) delineate competences of these organs;
- (3) outline procedures to be followed to modify constitutional rules and pass sub-constitutional rules; and
- (4) specify individual rights.

Any country that produces a minimum amount of public goods can thus be said to have a *de facto* constitution. This implies that constitutions do not always need to be written documents, as the production of public goods could simply be following generally accepted conventions. And indeed, the English Constitution is largely based on what Dicey (1885) has termed "constitutional conventions." But knowing with any degree of certainty which rules have acquired constitutional status is no mean feat (Marshall and Trotter 1984, discusses the theory of conventions following Dicey).

Furthermore, having a *de facto* constitution is not the same as having a constitution in the sense of constitutionalism. Constitutionalism is concerned with constraining government action to certain areas and restricting the means government can employ in the production of public goods.² Societies in which the government stays within the limits laid down by the constitution are said to have an effective constitution, or, in other words, there is congruence between the society's *de jure* and *de facto* constitutions.

1.3 Concepts of the Constitution

In this section, we briefly summarize different ways to analyze constitutions. Depending on the questions that the analysis focuses on, one is led to rely upon different concepts of a constitution. Since the analysis focuses on different questions,

² Within the (Western) tradition of constitutionalism, much emphasis has been placed on the constraining side of constitutions. Ever since Thomas Hobbes, the state has been portrayed as Leviathan. However, compared to anarchy, the state can also make everyone better off, a view that should lead to equal emphasis on the enabling parts of the constitution.

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the concepts are not necessarily mutually exclusive. All of them allow one to draw implications for real-world constitution-making.

1.3.1 The Constitution As a Social Contract

First-generation constitutional economists were primarily interested in legitimizing the state. Many of them drew extensively on social contract philosophers such as Hobbes, Locke, and others. Buchanan (1975), for example, describes the situation under which the members of a group are likely to pin such a social contract as an “equilibrium of anarchy” in which marginal costs and returns for producing, stealing, and protecting goods are equally high. The individuals realize that they could all be better off, if they could agree on a disarmament contract, which would allow them to reduce the resources used for protecting – and stealing – goods. Since the individuals find themselves in a prisoner’s dilemma situation, they all have an incentive to sign a disarmament contract – and subsequently not comply with it. As all individuals foresee this, they create a protective state to protect their private spheres. Additionally, they create a productive state which is to provide society with those (public) goods whose private production would not be profitable.

The idea that individuals create a state by way of contract is not meant to be a historically correct description but simply a heuristic. Buchanan believes it to be helpful not only in explaining existing institutions but also hopes to be able to derive from it some criteria for their evaluation (1975: 50ff.).

Probably the most relevant shortcoming of this concept is the incentives of those endowed with the competence to use force. Why should they abide by the rules if they could make themselves better off by reneging?

1.3.2 The Constitutional Contract As Principal–Agent Relationship

Principal–agent theory is developed out of the observation that contracting partners often dispose of differing information. A principal entrusts an agent with a number of tasks but cannot observe the actions of the agent costlessly. Additionally, the agent might have to act in situations too complex to be amenable for a clear-cut evaluation with regard to the respective aim. The agent thus disposes of a certain degree of discretion in her actions that she will use to maximize her own – and not the principal’s – utility. The main focus of principal–agent theory therefore lies on possibilities to constrain the agent and to design an optimal contract under the assumption of asymmetrically distributed information.

The members of society are thought of as the principals and the government as the agent. The problem consists of designing a contract – in this case, the constitution – in such a way that the agents will be led to maximize the utility of the principals. At the same time, the agents must still have incentives to not only actually do the job

(the participation constraint) but also do a good job. The Leviathan model introduced into constitutional economics by Brennan and Buchanan (1980) can be interpreted as a principal–agent model. The basic assumption of the model is that the government has incentives to maximize (tax) revenue beyond a level that is in the interest of the citizens. Their advice regarding the design of the tax constitution, therefore, is to limit the possibility of generating government revenue via taxes. They also recommend, for example, to explicitly limit the base on which taxes can be levied.³

Direct democracy institutions can also be interpreted as an attempt to alleviate the principal–agent problem between citizens and politicians by enabling citizens to make some decisions on their own instead of entrusting them to the representatives (their agents). The hope that one could be able to restrict politicians via an adequately designed contract has been evaluated quite critically by Tullock: “The view that the government can be bound by specific provisions is naive. Something must enforce those provisions, and whatever enforces them is itself unbounded” (1987: 317f.).

1.3.3 The Constitutional Contract As a Precommitment Device

Precommitment can be used as an instrument against one’s own (short-term) weakness of will. The most famous example of using precommitment in this way stems from antiquity: Ulysses had himself bound against the mast in order not to succumb to the singing of the Sirens. In economic parlance, the problem of *akrasia*, that is, lack of self-control, is often discussed under the heading of time-inconsistent preferences. While principal–agent theory contains a modification of traditional theory by taking account of the fact of asymmetrical information, the precommitment approach contains a modification with regard to the imputed rationality of the actors.

If individuals as well as entire groups can be subject to time-inconsistent preferences, one could ask whether societies are capable of protecting themselves from those inconsistencies by precommitment devices. This would presuppose that (a) the members of the respective society know their own weaknesses, (b) the members dispose of an adequate technology for precommitting themselves, and (c) a vast majority of the society’s members – including its politicians – are willing to restrain themselves by such mechanisms. From a normative point of view, one could ask why a society at one point in time should be able to bind the society at a later point in time. Since it could be made up of different individuals, one could even question whether one would still be dealing with the same society. Additionally,

³ In a follow-up to the original Leviathan model, Brennan and Kliemt (2019) point out an important gap in the original model. If governments are constrained in levying taxes, they are likely to turn to regulation instead. If they are able to “sell” it, supplying regulation can make themselves better off. For citizens, the costs of regulation might, however, even be higher than those of taxation.

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preferences might also shift. In those cases, flexibility would be preferable to pre-commitment from an ex ante perspective. (Elster (1984) discusses the Ulysses procedure and presents various devices used throughout history; the work by Holmes (1988) contains a discussion of the normative issues at stake). Elster (2000) observes that, in reality, people regularly want to bind others, but rarely themselves. This is a partial withdrawal from his earlier position that societies do, in fact, use constitutions to commit themselves and that this is normatively desirable. Since constitutions are often written in times of crises, it is rather questionable whether constitution-makers are sufficiently dispassionate to have the long-term interests of their societies in mind. Moreover, even if feasible, precommitment might not be desirable since it can easily clash with efficiency and/or democracy.

1.3.4 The Constitution As a Bundle of Conventions

Some constitutional scholars argue that the constitution cannot meaningfully be conceptualized as a contract, rather that it is comparable to social norms which emerge unintentionally and which are accepted by most members of society in a general and unconscious way (e.g., Hardin 1989; Ordeshook 1992). Constitution-making can then be thought of as an attempt (i) to hasten the process of the emergence of conventions and (ii) to guide the process in a certain direction. Hardin writes: “Establishing a constitution is a massive act of coordination that creates a convention that depends for its maintenance on its self-generating incentives and expectations” (1989: 119). Since the concept is developed out of dissatisfaction with and in explicit contradistinction from the “constitution as contract” notion, here are four differences between the two concepts. First, a contract serves to solve a prisoner’s dilemma, whereas a constitution (thought of as a bundle of conventions) serves to solve a coordination game that can, however, include a considerable degree of conflict. Second, for a contract to be valid, the explicit consent of the contracting parties is necessary, whereas a constitution can be viable without the explicit consent of a majority as long as there is no serious opposition. Third, the enforcement of a contract is usually secured by the availability of external sanctions, whereas a constitution is secured by the immense difficulty of establishing an alternative constitution. Fourth, contracting parties frequently try to take as many contingencies as possible into consideration, which often gives contracts a static character, whereas constitutions are more easily amenable to evolution.

Recently, this concept has been pushed forward by Hadfield and Weingast (2014), who start by observing that constitutional rules need to be enforced somehow. Since there is no level of law that is more basic than the constitution, they assume that the most important actors in the enforcement of constitutional rules are the citizens. A citizen who observes that somebody else’s constitutional rights are being infringed upon by the government could oppose that government. But such action comes at a

cost. Hadfield and Weingast argue that the likelihood that such opposition will ever come about is mainly driven by the beliefs about other people's likely actions. The beliefs, in turn, are a function of the law relying on distinctive reasoning and on a set of legal attributes. The distinctive reasoning needs to be as clear as possible about what is "constitutional" and what is not. People need to know whether the government stays within the confines of the constitution or not, and such distinctive reasoning can facilitate the establishment of such a clearly identifiable line.

According to Hadfield and Weingast (2014), many constitutional traits that have been identified by legal philosophers as normatively desirable traits of law can be better understood if their function in facilitating the solution of coordination problems between the citizens is given center stage. Lon Fuller (1964), for example, famously argued that law should be (i) general, (ii) publicly promulgated, (iii) prospective (i.e., not retroactive), (iv) clear, (v) consistent (i.e., not contain any contradictions), (vi) practicable (i.e., not demand the impossible), (vii) constant over time, and (viii) congruent with the actions of officials. Hadfield and Weingast (2014) now argue that most of these traits are a necessary condition for citizens to form homogenous beliefs about whether government behavior is constitutional or not, and whether they themselves should invest in costly opposition. If rules are not clear – to take only one concrete example – the likelihood of broad opposition against the government is low because it might not be clear whether the government has reneged against the constitution or not.

1.3.5 The Constitution As the Result of an Evolutionary Process

Buchanan, as an adherent of the social contract notion of constitutions, conceptualizes individuals as rational actors who have enough foresight to recognize that rules and their implementation have advantages. Because of this foresight, rational actors are willing to consciously constrain their possible range of actions. Hayek, as the best-known representative of an evolutionary notion of constitutions, turns this concept upside down: Man became rational only after he began following some rules. According to this notion, the emergence of (constitutional) rules is not the result of an explicit process of rational choice but the unintended result of human action, rather than of human design. Hayek extends this notion by suggesting that the actors are unable to establish a comprehensive theoretical knowledge about how rules function. Instead, he repeatedly stresses that actors dispose of subjective knowledge that can only partially be communicated and, therefore, cannot be aggregated (e.g., 1945; he developed his notion of the constitution in 1973, 1976, and 1979). Although both Buchanan and Hayek share the assumption of methodological individualism, Hayek stresses that individual actors rely on the surrounding group. In his eyes, trying to rationalize the existence of order in society by drawing

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on the Hobbesian war of everybody against everybody is a nonstarter, because survival can only be thought of as occurring in groups (1988: 12).

The concept of the constitution as the result of social evolution does not rest on “as if” explanations but on descriptions that claim historical accuracy. Constitutional rules are seen as the result of a trial-and-error process. The constitutional rules that survived the evolutionary selection process must have done a better job regulating group interactions than competing rules that did not survive. Part of the selection process, which takes place simultaneously, is groups observing each other. Those groups that are perceived to be more successful are imitated, supposedly implying that their rules will also be imitated. Hayek does not offer an explicit measure of the efficiency of a constitution, but he seems to be willing to derive the adequacy of an existing rule-set from the (relative) capability of a group to grow in size and feed its members.

The group observational part of the selection process just mentioned has received the attention of economists under various guises and names. Some have called it “institutional competition,” while others have called it “systems competition.” More recently, the idea that institutions could spread via “spatial diffusion” has received some attention. These guises and ideas are broadly in line with the notion of the constitution as the result of an evolutionary process. As mentioned above, the English Constitution can be thought of as the outcome of an evolutionary process. It is tempting to speculate that in developing this theory, Hayek was inspired by English history, whereas Buchanan was inspired by US history. Congleton (2011) describes the constitutional development of a number of Western parliamentary democracies as an evolutionary process from the point of view of constitutional economics. Interestingly, he also shows that the United States, rather than having created a constitution from scratch, fits the evolutionary model rather well.

1.3.6 Summary

Some of the concepts briefly discussed are quite complement, rather than being mutually exclusive. The first three approaches are united by their (implicit) assumption that a constitution can be created from scratch. It is in some of the central assumptions that these approaches differ from each other. Social contract theory not only assumes far-reaching rationality of all actors involved but also a capacity of all members of society to make credible promises, implying the capacity to bind oneself. The principal-agent approach introduces the possibility of asymmetrical information between principals and agents. The notion that a constitution is a precommitment device introduces the possibility that actors might suffer from time-inconsistent preferences or lack of self-control.

In game theory, a convention is a solution to a pure coordination game which has more than one equilibrium in pure strategies. Once reached, those interacting are

unlikely to move away from a convention and it can become self-enforcing. Analyzing constitutions as conventions thus focuses on the necessity that they need to be self-enforcing. Thus, conceptualizing constitutions as convention puts the most important shortcoming of social contract theory center stage.

1.4 The Tools

1.4.1 Theory

An assumption entirely undisputed in modern economics is methodological individualism. If all the processes and outcomes on the constitutional and postconstitutional level are the product of human action, they must – in principle – be explainable by pointing towards individual behavior that brought them about. From this assumption, it follows straightforwardly that the behavioral model focuses only on the behavior of individuals.

The behavioral model used in constitutional economics should be general enough to be applicable to all those actors who are potentially relevant for the creation, modification, interpretation, and implementation of the constitution. This set of actors includes a wide range of individuals. There are scattered and unorganized individuals, representatives of organized interest groups, voters, politicians representing political parties and various branches of government, as well as judges who are assigned the task of interpreting the constitution.

In economics, the behavior of the actors is usually modeled as the result of their utility function and the means available to maximize this function. Preferences are assumed to be stable over time. The “means” component not only includes their monetary resources, but also the theoretical, technological, and situational information that the actors are assumed to have, as well as the capability to process this information (their “rationality”). If these elements are sufficiently specified, one possesses a behavioral model.

Homo economicus has been criticized at least as much as it has been hailed by economists. *Homo economicus*, as conventionally portrayed, is endowed with a utility function that is maximized rationally. Under these assumptions, it is not only irrational to vote in large number settings (because the likelihood of casting the decisive vote is very close to zero but the costs of participating are larger than zero), but it is equally irrational to acquire information about the working properties of alternative constitutional rules. Chapter 4 of Brennan and Buchanan (1985) contains an ardent defense of the assumption that all individuals, including politicians and constitution makers, strive to maximize their utility. The authors aim at convincing their critics that this assumption is not only adequate for market contexts, but also for the behavior in non-market ones. Their main argument is concerned with

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methodological consistency. Since it is the same individuals who act in market and non-market settings, it would be inconsistent to operate with two (or more) different behavioral assumptions. This, however, is only an argument for always using the same model, but not necessarily for using *homo economicus*.

For their substantive defense, they claim that a behavioral model that is based on average behavior overestimates the benefits produced by altruists and, correspondingly, underestimates the costs produced by egoists. The individuals who are evaluating alternative institutional arrangements would, thus, be smart if they chose a worst-case scenario. In other words, Brennan and Buchanan explicitly opt for an assumption that might well be descriptively wrong. The imputed asymmetry would lead the individuals in the constitutional choice-situation to behave risk-averse. Although they might actually very well be risk-neutral, the purported asymmetry would lead them to behave *as if* they were risk-averse.

In subsequent writings, either with different co-authors or on their own, Brennan and Buchanan have both somewhat modified their positions. Brennan explicitly rejected the central notion of the 1985 argument, behavioral neutrality between market and political behavior (Brennan and Lomasky 1993: 14 and *passim*). At the end of the day, behavioral models have a straightforward purpose, namely to reduce complexity and to put all the emphasis on a limited number of core assumptions. It is the purpose of a model to abstract from many traits; otherwise, it would simply be a replication of reality.

Spelling out one's assumptions explicitly is a precondition for producing theoretical conjectures regarding the effects of some constitutional rules. Suppose we have produced a theoretical model that allows us to generate well-specified predictions. The next step then consists in testing these theoretically derived claims empirically.

1.4.2 Empirics

When we are interested in the effects – economic or other – of constitutional rules, we hope to be able to identify some constitutional rule *x* causing some effect *y*. Unfortunately, establishing causation is particularly difficult in constitutional economics because the variable hypothesized to cause some effect is never truly exogenous. All constitutional rules are the result of some more or less explicit deliberation, bargaining and collective decision-making process.

To establish causation, econometricians have established randomized experiments as a kind of gold standard. This would imply “treating” some countries randomly with a particular constitutional rule (or an entire constitution), whereas other countries remain untreated. If countries are chosen randomly, other factors (like their