Constitutional Economics

- Constitution: Set of rules governing the process of social decision making
- Includes voting procedures and basic rights
- However, aggregation preferences over all members of society is difficult
- Hence, is public choice theory appropriate for the analysis of constitutions?
The social contract: A thought experiment

- Starting point: Hobbesian state of nature
  - No state exists
  - Homo homini lupus est
  - Appropriation of resources by the strongest
- Yet, all individuals can be better off if they agree on building a state.
- Problem: All decisions need to be taken anonymously
Remember the idea of an optimal majority?

C: Coercive External costs

D: Decision making costs

Aggregate cost

Number of constituents whose agreement is required
The coercive external costs are the expected costs of being in the minority – having a collective decision go against one self.

These costs are a function of the number of individuals who are required to be decisive.

If the decision rule is unanimity, for example, then the expected external costs will be zero – you can never be forced to approve a collective decision that violates your interests. Expected external costs will be higher the lower the decision rule.

Note that these are the costs of a rule that will govern many future choices.
Decision making costs

- Decision making costs are the costs of discussion, organization, bargaining etc.
- Decision making costs rise with the decision rule. Why?
- Holdouts and transaction costs.
Individual calculus when forming a decision rule

C: Agg. loss of individual utility from an opposed law

D: Consensus Costs
The veil of ignorance – a thought experiment

- Assume that at the time of contracting individuals don’t know their status and preferences
- Individuals decide on the structure of government, the constitution, during a time when they do not know or are somewhat uncertain of their individual interests.
- Initial concept of the veil of ignorance by philosopher John Rawls, deriving a notion of justice from it (maxi/min rule)
- Choice of the rules to govern the future game is by unanimity.
- With equal probabilities the individual choice reflects the aggregated choice presented in the lecture on voting rules!
- The optimal decision making rule will vary depending on the cost functions.
- An area of choice involving potentially very high external costs (e.g. religion, free speech, basic property rights, modification of the constitution) will have very high external costs that will not fall until near-unanimity is reached.
- Required majority discriminated by issue is ex ante efficient (How about ex post?)
Collective decisions vs. Non-regulation

<table>
<thead>
<tr>
<th>Alternative</th>
<th>Cost</th>
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<tbody>
<tr>
<td>A – Do Nothing</td>
<td>Live with the externality or underprovision of the public good.</td>
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<tr>
<td>B – Voluntary Collective Action</td>
<td>Some externality and underprovision costs remain.</td>
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<tr>
<td>G – Government/Politics/Coercive Collective Action</td>
<td>Decision making and organization costs and the cost of being in the minority (i.e. above-discussed Case)</td>
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Possible Cases
Heterogeneity

What is the effect of greater heterogeneity on the optimal constitution?

1. External costs rise because the fear of being in the minority increases.
   - The external cost function will be high if the society is heterogeneous in income, religion, ethnicity or other factor.

2. Decision making costs increase because it is more difficult to get agreement in heterogeneous group than in a homogeneous group.

3. The optimal decision making rule could go either way depending on whether the increase in the external cost or decision making cost function is greater.

4. Total C+D costs increase for certain so fewer decisions should be made collectively.

The optimal policy rule is time and place dependent. What happens when a society becomes more heterogeneous but the decision making rule does not change?
Group Site and the Optimal Constitution

- It’s easier to get agreement among 55 of 100 than among 550 of 1000. i.e. decision making costs increase in the number of people required to agree for any given decision rule.

- Implications?