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Democracy and Economic Performance Revisited: A Constitutional Economics Perspective

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Abstract:

This paper explores the relationship between democracy and economic performance from a constitutional economics perspective. It is argued that such an analysis have to challenge some of the basic concepts which are widely used in most of the studies in this field. First, the procedural character of democracy is outlined, and the nature of the relation between the two ideals of democracy and constitutionalism is analyzed. Then, the state is regarded through a constitutional perspective in order to point up that individuals are not only confronted with a collective decision problem but also with a distributional problem what can be characterized as a 'two-sided distributional problem'. After critically reviewing the prevalent classification of constitutional rights, a new classification in membership rights and freedom rights is suggested what indicates that not any state activity necessarily expands the political-collective arena at the expense of the individual domain.

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1. Introduction

Even though much effort has been undertaken in studying the effects of political institutions on economic performance, theoretical and empirical ambiguity is still prevalent. Addressing the issue whether democracy fosters or hinders economic growth Przeworski and Limongi (1993: 64) conclude in their survey article: “The simple answer to the question with which we began is that we do not know whether democracy fosters or hinders economic growth.” Przeworski and Limongi sum up with this statement one of the main results in the literature dealing with the relationship between political institutions and economic performance. Following Huntington (1987) and Sirowy and Inkeles (1990) three lines of thought can be discussed: first, the “conflict perspective” argues that democracy detracts from economic growth, particularly in less developed countries. Second, the “compatibility perspective” contends that democracy enhances economic growth. And, third, according to the “skeptical perspective”, there is no systematic relationship between democracy and economic development.

When studying the literature exploring the relationship between political and economic institutions and their economic performance two phenomena are striking. First, a host of inquiries show a theoretical and/or an empirical inconclusiveness about the impact of democratic regimes on economic performance. And, second, as a rule, most of the contributions chiefly focus on empirical investigations without elaborating a comprehensive theoretical framework. Particularly, this is striking when approaching the issue from an institutional and constitutional economics perspective. In most of the contributions democracy is solely seen as majority rule, thus leaving apart the fact that “real world-democracy” is not operating in an institutional vacuum but always in a more or less well defined institutional-organizational structure. Thus, to put the interplay between democratic regimes and economic success in perspective, it is necessary to explore the relevant forms of the institutional embodiment of the idea of democracy.

The following contribution has to be considered as a first step towards an institutional analysis of democratic regimes. The aim of this paper is to analyze the nature and the impact of democracies on the economic success from a constitutional economics perspective. For this purpose, it is necessary to elaborate the conceptual framework for addressing the issue of the relationship between democracy and economic performance. Hence, the main focus of the paper is on the systematic and theoretical foundations of an appropriate constitutional economics application. The contribution proceeds as follows: In section 2, the theoretical and normative framework of the constitutional economics approach is presented. In particular, the

“gains-from-trade”-paradigm as the conceptual transfer of the procedural logic from the market arena to the political-collective realm has to be pointed out. In paragraph 3, the concept of democracy as a cooperative venture is examined more closely, in contrast to democracy as majority rule, which seem to represent the democratic ideal in most of the (empirical) studies. In section 4, a constitutional analysis of the state is supposed to draw attention on two issues which have a wide impact on the economic performance of collectives. Then, a new classification of constitutional rights is suggested in paragraph 5, where some usual classifications are critically discussed. Some effects of what is called ‘membership’ rights and freedom rights is analyzed in section 6. The conclusion in the last paragraph provides a brief summary and an outlook on further research in the field of constitutional analysis of the interplay of democracy and economic performance.

2. Constitutional economics as the economics of rules

2.1 Theoretical and normative foundations

Before proceeding to the nature of democracy and its impact on economic success, it makes sense to outline the constitutional political economy approach as the theoretical and normative framework deployed in this paper. Constitutional political economy is “a research program that grew out of the tradition of Public Choice theory and that sees itself as a paradigmatic alternative to traditional welfare economics” (Vanberg 2005: 24). The constitutional economics approach can best be understood as the economics of rules, which was mainly initiated by the seminal work of James M. Buchanan (Buchanan 1990; Brennan and Buchanan 1985), but does also have other important sources, such as, particularly, the work of F.A. Hayek on the limits of knowledge and the reason of rules (Vanberg 1994: 109ff.). A significant, but internationally little known precursor is the Freiburg School of law and economics. The research program of constitutional economics is part of the broader field of approaches in modern economics that can be summarized under the label *new institutional economics* (Van den Hauwe 2000).

In contrast to the neoclassical tradition in economics, constitutional economics explicitly acknowledges the fact that real world human agents are imperfect agents, i.e. human beings acting with limited knowledge and limited mental capacities. Its main concern is about the working properties of alternative rules and institutions and, in Hayek’s words, how the order of rules affects the resulting order of actions (Hayek 1969). Central to constitutional economics is the distinction between two levels at which individuals can choose: the constitutional level of rule choice and the sub-constitutional level of strategy

choice within given rules. The practical concern is about how individuals can improve their political and economic arrangements within which they live by adopting better “rules of the game”. Usually, the game metaphor helps to draw attention to the fact that, as in an ordinary game, the playing of the game is systematically dependent on the rules of the game. This holds true for any “game” in the economic and political life.

Constitutional political economy as theoretical science explores the systematic relation between the order of rules and the order of actions. Like modern economic and social theory it strictly adheres to methodological individualism, seeking to explain social phenomena in terms of the actions of the individuals involved and of the effects of their interactions and cooperative efforts. As an applied science it seeks to provide useful insights as to what rules of the social game are conducive to mutual beneficial cooperation and peaceful human coexistence. The normative standard is thereby provided by normative individualism in the sense “that the individuals involved must themselves be respected as the ultimate judges on what qualifies as ‘good’ or desirable in their social transactions and rule-arrangements and that, accordingly, the ‘legitimacy’ of transactions and arrangements ultimately derives from their voluntary agreement” (Vanberg 2005: 25f).

2.2 *The “Gains-from-Trade”-Paradigm*

The constitutional economics approach starts from the notion that economics, generally, “should be properly viewed as *the science of the gains from trade*, as the science that specializes in studying the means and ways by which people can reap mutual benefits from voluntary cooperation” (Vanberg 2005: 26). Whereas the traditional focus of economics is more on voluntary exchange in the market arena as the paradigm case of mutually beneficial social transactions, constitutional political economy extends the ‘mutual gains from trade’ idea to voluntary cooperation in a more comprehensive sense, i.e. including arrangements for collective action, both private and public (Buchanan 1979: 27ff.). Its main focus is on the question of how individuals may realize mutual gains through voluntary joint commitment to rules (Buchanan 1991: 81ff.). In short, constitutional economics complements the traditional focus on mutual gains from exchange in the market realm by exploring into how individuals as citizens may realize mutual gains from joint commitment.

The constitutional economics perspective especially looks at behavioral constraints, often only implicitly analyzed in mainstream economics. These are defined by norms, rules and institutions enforced in the social and economic environment within which individuals act and interact. The typical focus of constitutional economics is on *choices among constraints*

(Buchanan 1991: 4f.): although the rules prevailing in historically evolved social groups and communities are far from purposeful intention and willful change, the individuals can choose to change certain rules under which they are living and to adopt new rules and institutions leading to a better game.

From the perspective of a normative individualism, the claim that social arrangements are socially beneficial can only mean that arrangements and transactions are mutually beneficial, i.e. make all persons involved better off. When taking a consistently individualist-subjectivist position, the question what may count as “better” in social and economic affairs, can ultimately only be judged by the individuals concerned themselves, and, therefore, the relevant test for what meets the criteria of a “better game” must be seen in the voluntary agreement of the persons involved (Buchanan 1960: 122). In the case of individual exchange in the market, the assertion that both parties make themselves better off in terms of their own judgment, finally, can only be based on the evidence of the voluntary agreement of the parties to the transaction. In this sense, the standard notion of “efficiency” of market outcomes is ultimately derived from the conjecture that they are the result of voluntarily agreed-on transactions. Constitutional economics carries on the argument that, as a matter of consistency, the same logic should be applied to all other kinds of social cooperation, both private and public. Consequently, what is usually called “efficiency” and mutual advantage “can, in their case too, ultimately be diagnosed only on the ground that all parties voluntarily agree on the desirability of the respective arrangements” (Vanberg 2005: 28).

3. A procedural theory of democracy

It is necessary to clarify the meaning of democracy in the following analysis because there is a great deal of various definitions and different notions of ‘democracy’. Most notably, in the bulk of the economics literature, democracy is usually understood as a form of collective decision rule, that is to say as simple majority rule. In this connotation, democracy is based on the principle “one person one vote” and allows for political participation of individuals regarded as equals. More precisely, the majority rule satisfies the criterion of ex ante political equality. Contrary to this widespread use of the term, the following sections draw on a contractarian constitutionalist perspective on ‘democracy’.

3.1 Democratic states as cooperative ventures

At the outset of the following analysis it is useful to introduce a distinction. Definitions of democracy can be distinguished between primary and secondary definitions (Vanberg 2004:

52). Primary definitions of democracy do not address issues concerning institutional features of a democratic order. John Rawls provides such a type of democracy definition in suggesting that a democratic polity can be considered “as a cooperative venture for mutual advantage” (Rawls 1971: 84). Following the Rawlsian description Viktor J. Vanberg defines a democratic polity as a club or a cooperative which is supposed to serve the common interests of its members or citizens. Consequently, democratic polities can be called “citizens cooperatives”. “Just as *cooperatives*, as *member-owned* enterprises, are there to promote the interests of their members, democratic politics, as ‘*citizens cooperatives*,’ are there to serve the common interests of their members, the citizens” (Vanberg 2003: 201). Accordingly, the institutional framework of democratic politics represents organizational means that may further citizens’ mutual benefits and prevent exploitation by other citizens, groups or political agents.

The idea of democracy as a cooperative venture represents a generic term or basic definition of democracy. This definition does not yet imply a particular institutional (‘democratic’) design of the democratic collective. Thus, no preliminary decision in favor of a concrete institutional-organizational arrangement of the citizens cooperative is made by this primary definition of democracy.

Differently from this kind of democracy definition, secondary definitions provide an account of democracy which already addresses particular institutional and organizational characteristics. This applies to mostly predefined notions of “democratic institutions”, in particular to the governance by majority rule, and to other concepts of democracy emphasizing the role of elections, representative government or party competition. The major difference between preliminary and secondary definitions of democracy is the treatment of the issue about which institutional setting is best suited for achieving the aim of securing mutual benefits of the cooperatives’ members. In view of the primary definition, this is a matter of facts which have to be proven theoretically and empirically, while secondary definitions are inclined to “resolve” this issue by definition.²

Starting from Hobbes, the fundamental problem of social order deals with the question of how to enhance the prospects for realizing mutual gains. This does also involve the task of preventing mutual harm which easily arises from the omnipresent temptation to seek for advantages while impairing others. As James M. Buchanan laid down in his seminal contribution to the field of constitutional political economy, the economist’s “gains-from-trade paradigm” can (and should) be extended from the market arena to all kinds of social and

² “Accordingly, institutional provisions in a democratic polity are to be ultimately judged in terms of their suitability to serve that purpose, not in terms of predefined notions of ‘democratic institutions’” (Vanberg 2003: 200).

political arrangements, also including collective action and constitutional choice (Buchanan 1979). Buchanan argues that individuals can realize mutual gains from trade not only by entering into decentralized market transactions taking place as bilateral exchange. Another important kind of social transactions comes about in the realm of politics, where a similar kind of “voluntary exchange perspective” can be adopted, i.e. as an arena where individuals in their capacity as citizens are able to realize mutual gains through collective action.

From the point of view of a generalized gains-from-trade paradigm, political organization is understood as an instrument for ensuring mutual benefits. Individuals can organize themselves in polities at various levels such as communes, states, nation states and supra-national entities, as a method for them to capture mutual gains that otherwise may not be secured, i.e. through decentralized market transactions or by organizing themselves in private “clubs” (Buchanan 1987). What is usually described by the term “public goods” represents those benefits which can only be captured by means of political organization (cf. Vanberg 2003).

3.2 The Notion of Citizen Sovereignty

The criterion for efficiency implied in the constitutional economics concept of democracy as outlined above may be called “citizen sovereignty” (cf. Vanberg 2003, 2004). This concept is related to the idea of consumer sovereignty which, as a criterion to evaluate the working properties of market institutions, calls for an institutional design of markets with strong incentives for producers to be most responsive to consumers’ preferences and values. Accordingly, “citizen sovereignty means that the political process should be institutionally framed in such a way that citizen preferences are its principal controlling variable, that the ‘producers of politics,’ politicians and government bureaucrats, are made most responsive to citizens’ common interests” (Vanberg 2003: 201). Just as consumer sovereignty, the criterion of citizen sovereignty is a procedural one; consequently, it cannot be directly applied to outcomes. Appropriate evaluations of political outcomes are only possible when based on the processes from which they emerge. The extent to which democratic polities meet the criterion of citizen sovereignty is connected with two questions: first, how well can constitutional provisions and organizational structures be assumed to enable citizens to realize common interests, and, second, is there any protection provided for the individuals from exploitation by other individuals or political agents?

The principle of citizen sovereignty claims that the individual citizens organizing themselves in a democratic polity remain the ultimate sovereigns in whose common interests

the collective enterprise has to be run. For this reason, the ultimate authority of decision-making rests, at any given time, with the current constituents, and it is always in respect of their common interests that the outcomes and results of a democratic polity have to be legitimized.

3.3 *Democracy and Constitutionalism: Two contrasting ideals*

To unravel the jigsaw puzzle of democratic regimes and their economic success it is very important to distinguish clearly the idea of democracy from the concept of constitutionalism and liberalism, respectively. While democracy and constitutionalism, considered analytically, deal with different problems, Hayek pointed out that liberalism, and accordingly constitutionalism, became closely connected with the movement for democracy through the strive for a law which is the same for all, and for the consequent denial of all legal privilege (Hayek 1978a: 142). As a matter of principle, constitutionalism/liberalism is about the government functions and particularly about the limitations of all its powers. In contrast, democracy is concerned with the question of who is supposed to govern. Constitutionalism claims that all power, i.e. also that of majority, has to be limited. One of the main results of the democratic idea is seen in the fact that current majority opinion is taken as the only criterion of the legitimacy of the government powers (Hayek 1960). As a result, the ideal of democracy concerns the procedures by which political decisions should be made, and the ideal of liberalism relates to the constraints that should be imposed on political authority (Vanberg 2003).

The relationship between democracy and liberalism is in the heart of F.A. Hayek's works. According to him, liberalism is "the same as the demand for the rule of law in the classical sense of the term" (Hayek 1967: 165), giving rise to the limitation of the coercive power of governments to enforce universal rules applying to any individual in the same manner, and to protect "a recognizable private domain of individuals" (ibid.: 162). In particular, Hayek puts emphasis on the fact that the liberal principle rests upon the ideal of a non-discriminating and privilege-free social and economic order.³

In the beginning, according to Hayek, liberalism was closely related to the democratic movement and its struggle for equal political participation rights, because it insisted on a law applying for all individuals and strictly opposed all legal privilege. He points out that in their

³ Hayek (1979: 142) notes: „The basic conception of classical liberalism, which alone can make decent and impartial government possible, is that government must regard all people as equal, however unequal they may in fact be, and that in whatever manner the government restrains (or assists) the action of one, so it must, under the same abstract rules, restrain (or assist) the actions of all others.”

common engagement for a constitutional government both ideals were often indistinguishable, although aiming at different goals: “Liberalism is concerned with the functions of government and particularly with the limitation of all its powers. Democracy is concerned with the question of who is to direct government” (Hayek 1978b: 142f.). Hayek maintains that, as a result of the victory of democracy over authoritarian and despotic regimes, people adopted the erroneous view that “the safeguards men once painfully devised to prevent abuse of government power are all unnecessary once that power has been placed in the hands of the majority of the people” (Hayek 1978c: 96). This marks the starting point of the emerging conflict between the democratic and the liberal ideal. A notion of democracy became widely accepted which Hayek called “doctrinaire” and “dogmatic” (Hayek 1960: 105f.), a notion that considers “current majority opinion as the only criterion of the legitimacy of the powers of government” (Hayek 1978c: 143), and, consequently, “this same majority must also be entitled to determine what it is competent to do” (Hayek 1960: 107).

To draw a conclusion, it is not the proper ideal of democracy but its today’s prevailing interpretation that Hayek blames for fostering “the particular forms of democratic organisation, now regarded as the only possible form of democracy” (Hayek 1978b: 107), a form that he depicts as “unlimited democracy”, and which he blames for being responsible for the appearance of “a progressive expansion of government control of economic life” (ibid.). Thus, Hayek draws an explicit distinction between the fundamental principle of democracy, according to which all political power comes from the people, and its, now prevailing, institutional embodiment, namely (unrestricted) majority rule.

According to Hayek, both the liberal ideal of “freedom under the law” (Hayek 1960: 153) and its derived principle “of the necessary limitation of all power by requiring the legislature to commit itself to general rules” (Hayek 1978b: 108) are not menaced by the ideal of democracy per se but solely by the false belief “that this omnipotence of the representative legislature is a necessary attribute of democracy” (ibid.). Consequently, it is not the idea of the sovereignty of the people, seen as the principle “that whatever power there is should be in the hands of the people” (Hayek 1979: 33), what evokes Hayek’s critique. Rather, he criticizes the “constructivist superstition of sovereignty” (ibid.), i.e. the idea of a representative legislature operating under majority rule which should be endowed with unlimited power.

4. A constitutional perspective on the democratic state

An analytical perspective that concentrates on the procedural foundations of organized, collective action has been presented by J.S. Coleman in his contributions to a theory of organizations as corporate actors (Coleman 1974; 1986; 1990). He suggests to conceive organizations as decision making and acting units inasmuch they show the following characteristics. A number of persons have agreed to combine or pool certain resources, whatever these are, alienable or inalienable, monetary or non-monetary. These resources are used jointly, in combination, subject to defined procedural rules. In pooling resources for joint use, the individuals involved submit – explicitly or implicitly – to such procedural rules. The framework of these procedural rules and institutions provides the common basis for integrating their organizational cooperation. Procedural rules on which organized or corporate action is based upon, “can justly be viewed as a *constitution* because they *constitute* organisations as corporate actors” (Vanberg 1992: 240). When a group of individuals decides to create an organization by pooling resources for joint use, they are establishing – explicitly or implicitly – what can be considered as a constitution. And when a person joins an organization, he submits, with a certain part of his resources, to such a constitution. Being a member of an organization means, in the first instance, to give up separate control over some of one’s resources, “and to submit them to an organizational decision making procedure in which one may have – or may not have – a vote” (Vanberg 1992: 240).

From this constitutional perspective of pooled resources follows that, where a collective actor is assumed, any resources have to be specified, which are withdrawn from individual disposition of its members and transferred to a common pool of resources. For certain organizations the nature of such resources is obvious, for example in case of a particular legal form of companies, where financial resources such as capital or other kinds of financial investment are required. In general, to be accepted as a member in, for example, professional associations or other clubs and associations, a fee is required.

The state is a collective actor as well, one in which a common pool of resources is collectively and centrally disposed of. The members of the collective ‘state’ are its citizens, and (solely) in their capacity of citizen they invest a certain part of their resources in the common, state-controlled pool of resources. Different organizations may differ with respect to the kind of membership, as well as the kind and extent of resources which have to be transferred. Thus, collective actors vary in different aspects, among which are the number of members, the extent by which membership resources are bound, as well as the modalities to obtain membership and to resign from the organization, respectively.

In the following, the two fundamental problems are briefly addressed which all kinds of corporate actors must tackle. An organizational constitution does not only define the domain of the organization's decisions by ascertaining what and to what extent resources are under organizational disposition. The constitution has also to lay down the proceeding for the corporate enterprise. In particular, it is supposed to contain provisions for the kinds of problems that typically appear when individuals engage in organized or corporate action, problems that are basically of two kinds: Collective decision problems and distributional problems (Vanberg 1982: 16).

Problems of collective decisions arise because the joint use of resources, which are pooled by a group of input owners, calls for decisions to be made for such use for the group. Every group must have some provision – whether explicit or implicit – declaring who is entitled to make decisions for the group and how group decisions are to be made, i.e. according to what procedural rules. In other words, any organization must possess some procedural rules in order to make collectively binding decisions.

Problems of the second kind, i.e. distributional problems, emerge as a consequence of the joint-production nature of corporate action. The result of the joint, combined use of pooled resources is a joint output or group-product. Unlike individual efforts, in a collective effort the result is not generated in the form of direct, separate returns to the several input owners. Instead, the collectively generated gain has to be divided among the various members according to a distributional rule or principle. Every organization is characterized by – again, explicit or implicit – provisions defining how the individual members share in the contribution to, and in the return from, their collective effort. A great deal of potential solutions to both the collective decision problem and the distributional problem is conceivable, and one can expect, accordingly, to find a wide range of – explicit or implicit – constitutions on which organizations are founded (Vanberg 1982).

The virtue of this constitutional perspective on states as a theoretical instrument to scrutinize the relationship between democratic polities and their economic performance is that it systematically directs attention to both fundamental problems of corporate actors and its structural reasons. The first battery of questions concerns the rules and institutions applying to the disposition of the common resource pool. Second, the question is raised by which 'social distributional rule' the collectively yielded result is divided into individual returns (Vanberg 1982: 17).

5. Constitutional rights and the problem of separating market and state

Constitutional rights can be classified in many ways and based on different criteria. A common method is a division of rights into political and civil, economic, and social rights (Elster 1994: 211). The category of civil and political rights contains such rights like freedom of speech, freedom of association, and the rights that protect the equality of political participation. The set of economic rights is made up of provisions that guarantee property rights, freedom of contract and freedom of exchange. In the social category, finally, Elster places “a number of rights that are, as it were, intermediate between the right to the pursuit of happiness and the right to happiness itself, namely rights that ensure the provision of goods that tend to promote happiness” (Elster 1994: 211). According to him, these rights include for example the right to work and to job security, the right to a adequate income, the right to pension benefits, and the right to education and health care.

Through the distinction of political and economic rights it is possible to differentiate between the concept of democracy, on the one hand, and that of constitutionalism, on the other hand. Figure one helps to illustrate the possible combinations of democracy and constitutionalism with the presence or absence of political and economic rights. The issue of who is holding state power relates to the idea of democracy, and that of its opposite, autocracy. In contrast, the issue of the extent of state power is covered by the idea of limited government versus unlimited government.

Figure 1: The assignment of constitutional rights to different forms of government

Holder of state power	Democracy	Autocracy
Extent of state power		
Limited Government	<i>Both political rights and economic rights</i>	<i>Only economic rights</i>
Unlimited Government	<i>Only political rights</i>	<i>Neither political rights nor economic rights</i>

Another classification of constitutional rights is taken up by Berggren and Kurrild-Klitgaard (2000). They refer to what has traditionally been called “negative” rights, as restrictions on the individual’s actions affecting others. Constitutionally protected individual rights, both from the interference of temporary political majorities, and from other individuals, may have, notably, a number of positive effects on individual cooperation and, hence, on the economic success of a polity. When effectively guaranteed and protected they limit the costs which other actors, private as well as political, can impose on individuals. Most fundamentally, this makes it worthwhile for individuals and corporations to invest resources in productive activities (Berggren and Kurrild-Klitgaard 2000: 178). Obviously, this applies to those classical “negative” rights which are, in fact, economic rights: the right to own property, to contract and trade without intervention by government.

Unlike “negative” rights what has been indicated as “positive” rights implies that “citizens of a state through the constitution have a ‘right’ to, e.g., a certain living standard or other politically provided special benefits” (Berggren and Kurrild-Klitgaard 2000: 178). Apparently, “positive” rights resemble what Elster calls “social” rights, but, in addition, Berggren and Kurrild-Klitgaard indicate the nature of those rights. In contrast to “negative” rights and economic rights, respectively, the constitutional guarantee of “positive” rights means that, almost by definition, other individuals or groups of individuals have to bear the cost, and, hence, are restricted in the enjoyment of their (negative) rights.

Yet another classification of constitutional rights is in use when it is asked what empirical support can be found for the contention that these rights do matter for economic performance. Usually, in empirical studies the concepts of economic freedom and political freedom are applied to assess the degree to which negative rights are maintained and the degree to which positive rights are lacking, and also to analyze the effects on economic performance and prosperity. Gwartney, Lawson, and Block (1996), for instance, define the basic elements of economic freedom as the protection of private property and freedom of its use and exchange. Individuals are said to have economic freedom when two conditions hold: first, the property which they acquire without using force, fraud, or theft is protected from intervention by others, and, second, individuals are free to use, exchange, or give their property to other individuals as long as their actions do not come in conflict with the same rights of others. Thus, economic freedom is typically associated with a free market economy, the enforcement of contracts, and the absence of taxation and regulation (e.g. de Haan and Siermann 1998). The empirical studies conducted so far seem to be almost unanimous in their findings: countries with high economic freedom (i.e. small public sector, low taxes,

deregulated markets and trade, low inflation, etc.) systematically tend to show greater wealth and higher economic growth than other countries.⁴

Political freedom is usually defined as consisting of two essential components: political rights and civil liberties.⁵ Political freedom in terms of political rights appears typically as what has been called ‘positive’ rights, like the right to participate in elections (i.e. universal franchise), free and open elections (i.e. between alternative persons or parties), etc. According to Berggren and Kurrild-Klitgaard (2000: 182), such ‘positive’ political rights may also include various types of politically provided entitlements, such as social security, medical care, etc. In contrast, political freedom in terms of civil liberties is typically equated with those ‘negative’ rights (other than economic rights) like freedom of religion, freedom of the press, freedom of speech, freedom of association, etc. These rights are usually associated with the rule of law in a broader sense. In empirical studies, there is hardly any consensus on the effective relationship between political freedom and economic growth. Empirical results are ranging from a positive relationship, over no relationship at all, to a negative relationship (Berggren and Kurrild-Klitgaard 2000: 183).

As a result of the discussion of constitutional rights, the distinctive feature underlying most classifications is one of the contents. Hence, ‘political’ rights refer to ‘political’ affairs, ‘economic’ rights refer to ‘economic’ affairs etc. This kind of classification is criticized for not capturing appropriately the distinctive analytical differences between the two concepts of democracy and constitutionalism. Moreover, the concepts of ‘social’ rights and of political freedom confound different issues, namely rights and entitlements, and ignore the systematic difference between them.

In the following, another classification of constitutional rights for a more appropriate analysis is suggested. Instead of concentrating on different aspects concerning the content of those rights, it focuses on the two fundamental problems treated by the model of common pool resources: the collective decision problem *and* the distributional problem. Thus, the distinctive feature refers to the question whether rules and institutions are connected with the issue of participation in collective decisions or with that of separating the collectively produced result. Generally, constitutional rights may be divided into participation rights and freedom rights. However, specific entitlements which typically appear as ‘social’ rights could not be captured analytically: the following classification tries to cope with this issue:

⁴ See, for example, de Haan and Siermann (1998), Wu and Davis (1999), and Gwartney and Lawson (2000).

⁵ Confer, for example, Farr, Lord and Wolfenbarger (1998) and Berggren and Kurrild-Klitgaard (2000).

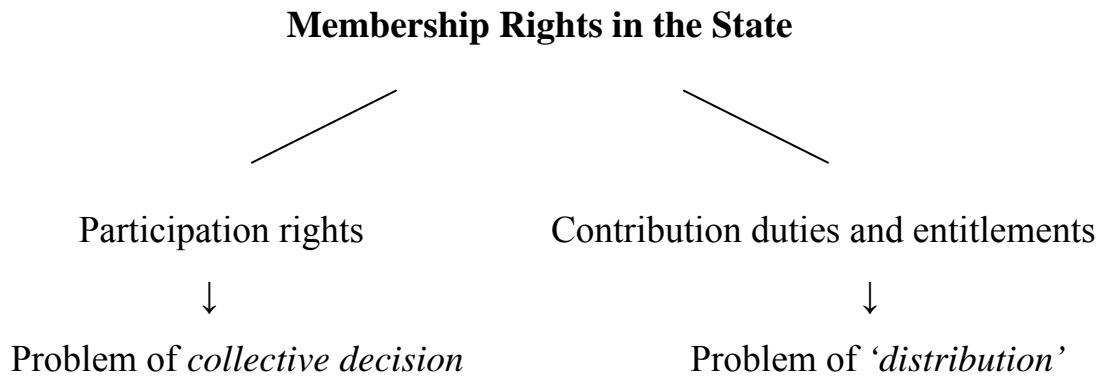
Membership rights in the state

Membership rights in a state define the terms which apply for the members of a democratic polity, i.e. for its citizens. They consist of *participation rights*, allowing members of any collective on different levels to participate to collective decisions. This also includes a guarantee of an equality of votes.

To exercise participation rights numerous organizational and institutional provisions are necessary which should not be confounded with the participation rights as such. Organizational arrangements are intended to alleviate, and in the first place to enable, respectively, the attendance and implementation of democratic collective decisions. The most important institutional provisions calling for a principal resolution are those concerning the question of the time interval of elections (i.e. length of the legislative period), the translation from votes into mandates (i.e. the design of the voting system), the selection of the government itself (i.e. the government system), and the forming of constituencies.

Moreover, the membership rights in the state also comprise what can be regarded as the bundle of individual *contribution duties and individual entitlements* to the state. These arrangements serve to solve the problem of the ‘distribution’ of the collective output, that takes here, unlike profit-oriented organizations and corporations, a more abstract form. In every polity, the individuals have to bring a certain part of their resources in a common pool in order to accomplish a given set of common tasks. Furthermore, people can agree to allow for additional special claims and entitlements of single members. From this it follows that, on the one hand, rules and procedures have to be laid down concerning which kind of entitlements are to be financed, and, on the other hand, which kind of contribution duties by the members are to be required. Thus, we face a ‘two-sided problem of distribution’ referring to an appropriate institutional framework for individual contribution duties and entitlements. Figure two illustrates the membership rights in the state from the above developed constitutional perspective:

Figure 2: Membership Rights and the two fundamental problems of collective action



Freedom rights

While the membership rights in the state, particularly the participation rights, constitute a right to take part in collective decisions, the function of freedom rights is to define and protect the individual domain. Individual freedom rights, basing on property rights and freedom of contract, limit the range of collective decisions. They constitute the private law domain and, thus, separate the market arena from the political-collective arena, i.e. the state.

It is important to note that in this view democratic states, as cooperatives seeking to realize citizen sovereignty, are confronted with two main issues: first, the issue of participation rights, which raises questions such as the appropriate choice of the collective decision rule, the delegation of power to political agents, and the decentralization of state power. All these issues relate to the fundamental problem of collective decision, and it is exactly this problem on which, generally, the bulk of the literature focuses. However, secondly, the neglected side of the story is that, like in any other organization, democratic states have to tackle not only collective decision problems but also distributional problems. It has been suggested that in the case of states as democratic polities, unlike other organizations, such distributional problems seem to appear as a ‘two-sided distributional problem’, because they constitute what can be characterized as contribution duties and entitlements.

Based on these considerations, the suggested (re)classification of rights is then twofold. Besides the above developed membership rights, there are also freedom rights. This new rights classification is illustrated in figure three; as in figure one, again, this classification of constitutional rights in membership rights and freedom rights helps to clarify the analytical distinction between both concepts of democracy, on the one hand, and that of

constitutionalism, on the other hand. Figure three illustrates the possible combinations of democracy and constitutionalism with the presence or absence of the respective rights.

Figure 3: The assignment of constitutional rights to different forms of government

Holder of state power	Democracy	Autocracy
Extent of state power		
Limited Government	<i>Both membership rights and freedom rights</i>	<i>Only freedom rights</i>
Unlimited Government	<i>Only membership rights</i>	<i>Neither membership rights nor freedom rights</i>

6. Effects of membership rights and freedom rights

To study the economic success of democracies the question comes to the fore of how the exercise of membership and freedom rights systematically depends on different rules and procedures, i.e. democratic institutions. In the remainder of the paper a brief look is taken at the simple majority rule as one possible democratic institution.

6.1 Membership rights

For the exercise of their *participation rights*, individuals have to take two kinds of costs into account (Buchanan and Tullock 1962): first, an individual (or a group) has to face the external costs of being overruled and seeing the own preferences not fulfilled. The higher the necessary consent required by the collective decision rule, the lower the probability to belong to the minority. The external costs, thus, decrease with increasing quorum. Second, individuals have to bear decision-making costs, or agreement costs, consisting in the negotiation costs emerging necessarily in the ongoing social process when an issue has to be decided collectively. The relation here is a direct one: the lower the quorum, the easier it will be to reach the necessary number of proponents. As a consequence, the agreement costs increase with higher majority requirements. The optimal level of votes must take both

components into account; through the addition of external and agreement costs to ‘interdependence costs’ it is possible to define the optimum – i.e. the minimal total costs.

For the exercise of *entitlements* it is necessary to distinguish two cases: first, it is only possible to resort to the common pool resources for particular claims. In this case the individuals are called to pay for the exercise of the entitlement in their role as citizens, i.e. as members of the state. A second case is the situation where not only common resources but also the resources of individuals as private law subjects, i.e. as members of the civil law society, come up for the funding. Differently from the first case, here the line between state and private law, that is between state and market, is shifted in favor of the former at the expense of the latter. This means that, when (‘democratic’) participation rights exist, a systematic extension of the state occurs, which is however not caused by the exercise of the participation rights per se, but a consequence of the existence and particular design of the ‘social entitlements’. Regulations serve often as a means to implement entitlements. These can shift property rights from the private subjects to the state, and thus lead to a collectivization of individual rights.

6.2 Freedom rights

Freedom rights are mainly protection and defense rights, not entitlements. They represent restrictions of individual behavior towards others. In this sense, constitutionally protected, individual freedom rights have positive effects on economic transactions, as they protect from interferences of temporary majorities as well as other individuals. Essentially, they reduce the costs that private and collective actors can impose on individuals and, in this way, it becomes worthwhile to invest in socially productive activities. This is particularly evident for the classic ‘negative’ rights such as private property, the right to make contracts etc. without limitations through government activity. The protection of individual freedom rights, at the same time, lowers the costs of collective decision-making at the individual level, because each individual enjoys a sphere in which he or she can act completely according to personal preferences. The expected external costs of decisions taken by thirds will decrease as well.

7. Conclusion

From a constitutional economics perspective the issue of the relationship between democracy and economic performance must start from the fact that the procedural character of democracy does not allow for confining the analysis solely on the majority rule. Furthermore,

it is important to see that the citizens of a polity have not only to tackle a collective decision problem but also a 'two-sided distributional problem'. Generally, in the literature the focus is mainly on the problem of collective decision, with all its implications for voting, bargaining, delegating power to political agents, and so on. However, in every democratic polity the individuals also have to agree on the extent of their contribution duties and entitlements to finance their state. This applies to a minimal state à la Nozick as well as to contemporary European welfare states.

The division of membership rights in the state into participation rights and contribution duties and entitlements should have been made clear that the existence of democratic participation rights per se does not give rise to an increasing political-collective domain. Rather, such problems arise because of deficient rules and procedures concerning the distributional problem of the state. A structural problem, certainly, is the fact that the government makes both the collective decision *and* the distributional decision. Further research has to explore what kinds of distributional patterns different real world political institutions generate.

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