CHAPTER 15

Summary and Conclusion

The philosophy of mercantilism, which prevailed in Europe until the late eighteenth century, praised monopoly as a device to enrich the state. By convention, modern economics originates with Adam Smith's attack on mercantilism in his book *The Wealth of Nations* (1776), which praises competition as a device to enrich the nation. In social science's most famous metaphor, Smith proposed that competition directs the butcher and baker, who look only to their own advantage, to maximize the nation's wealth, as if directed by an "invisible hand." A century passed before the marginalist revolution of the late nineteenth century mathematically formulated this metaphor (Blaug 1978; Schumpeter 1986). Mathematical improvements culminated in general equilibrium theory in the 1950s and 1960s, which provides a rigorous defense of competitive markets and a framework for analyzing market failures (Arrow and Hahn 1971). Subsequent developments in game theory detailed more precisely how competition usually works and sometimes fails (Fudenberg and Tirole 1991).

In 1776, the same year that Adam Smith published his most famous book, the United States issued its Declaration of Independence. Many Americans hoped to create the world's first mass democracy. After a false start, the present U.S. Constitution was adopted, which some of its framers described as a machine for good government by self-interested people.¹ Judging from *The Wealth of Nations* and the U.S. Constitution, the ideal of competition began its ascent in economics and politics at roughly the same time. Two hundred years later, with the collapse of communism after 1988, the principle of competition dominates the world's economic and political institutions, as well as economic and political theory. At least for a while, capitalism and democracy lack serious rivals.

Competitive markets cause private businesses to supply abundant private goods at low prices. Similarly, competitive elections ideally cause public institutions to supply abundant public goods with low taxes. Market competition satisfies the preferences of consumers for commodities better than an economic cartel does, and political competition satisfies the preferences of citizens for laws and public goods better than a political cartel does. Specifically, elections (democracy) satisfy citizens more than a self-perpetuating bureaucracy (civil-service state), a dominant social class (aristocracy), a ruling family (monarchy), an all-powerful individual (dictatorship), a priestly caste (theocracy), or a vanguard party (communism) does.

Whereas Adam Smith intuited the efficiency of market competition, general equilibrium theory proved it. Ideally, the economic analysis of politics would do

¹ See, for example, Madison 1981b, p. 160. Or see the letter from John Adams to Richard Henry Lee, 15 November 1775, reprinted in Adams 1851, quoted in Krasnow 1991.
for democracy what general equilibrium theory did for capitalism—prove that competition best satisfies the preferences of citizens. But is the efficiency of political competition provable? From the beginning, attempted proofs encountered difficulties. Instead of positive proof, mathematical theories discovered impossibility theorems demonstrating the limits of democracy. Decisions over public goods require collective choices, and Kenneth Arrow proved that a no democratic constitution can guarantee stable, Pareto-efficient, collective choices (Arrow 1963). Competition does not produce good results as predictably in politics as it does in economics. Unlike the economy, irreducible power and unending redistribution destabilize cooperation in politics. When cooperation collapses, selfishness destroys instead of energizing.

Even so, political competition aligns the ambition of politicians and the public good better than any noncompetitive system of political organization. This book predicts the extent to which alternative forms of democracy satisfy the preferences of citizens. I have used the positive methodology of individual rationality and the normative standard of preference satisfaction to justify democracy and critique its various forms.

In 1825 a revolt in Russia aimed to replace Tsar Nicholas with his brother, Constantine, and to promulgate a constitution. At the climax, revolting soldiers and aristocrats in St. Petersburg chanted "Constantine and constitution! Constantine and constitution!" Many of the common people apparently thought that "constitution" was Constantine’s wife. In any case, the Decembrist Revolt failed in part because too many Russians did not understand what a constitution is. A social scientist reading contemporary constitutional scholarship might wonder whether its authors know what a constitution is. Constitutional scholarship focuses too much on the constitution as an historical agreement and a repository of values, and not enough on the constitution as an incentive structure that affects behavior. Predicting the effects of a constitution on behavior requires social science, especially a policy science that predicts effects on policy variables like liberty, efficiency, and distribution. In this concluding chapter, I recapitulate the justification and critique of democracy by summarizing my major predictions. After the summary, I discuss the success of the strategic theory of democracy and its limits.

SUMMARY

Being a policy science, economics makes predictions about policy values. Statements about the consequences of alternative policies on values can be formulated as predictions or prescriptions. The prediction "x causes y" becomes the prescription "To achieve y, do x." I will summarize my predictions and prescriptions in the same order that they appear in this book.

2 Nicholas Riasanovsky, professor of Russian history at Berkeley, told me in private communication that insufficient documentation supports the claim of historical accuracy for this event, but the vignette accurately represents the mentality of common people in Russia. My thanks go to Nicholas Riasanovsky, Greg Grossman, and Blair Dean for discussing this point.
TABLE 15.1
Table: Factoring, Splicing, and the Character of Politics

<table>
<thead>
<tr>
<th>Constitutional Forms</th>
<th>Character of Politics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Factor</td>
<td>special governments, ballot initiatives</td>
</tr>
<tr>
<td>Splice</td>
<td>comprehensive legislature</td>
</tr>
</tbody>
</table>

Median Democracy v. Bargained Democracy—Optimal Number of Governments

According to part 2 of this book, a constitution and other fundamental laws can factor or splice the functions of government. To factor, the constitution creates many narrow governments, each with a limited purpose, such as the special governments common in the United States. The constitution can also factor by allowing ballot initiatives and referenda, each on a single issue. Alternatively, the constitution can splice the functions of government. To splice, the constitution creates one broad government to make all laws and supply all public goods.

Single-purpose governments and single-issue referenda increase the transaction costs of bargaining across issues. Taken to its logical limit, factoring eliminates political bargaining, which tends to eliminate vote trading and strategic behavior. Nonstrategic voting on a single dimension of choice often yields a stable equilibrium at the most preferred point of the median voter. I call such a political system, which the first row of table 15.1 summarizes, median democracy.

Alternatively, a constitution can splice functions by creating a few broad governments, each with many purposes. In such a system, the central legislature and executive hold most power, as they do in France or Japan. Comprehensive government by a central legislature decreases the transaction costs of bargaining across issues. Taken to its logical conclusion, splicing results in government by an encompassing bargain. Reaching a bargain requires vote trading and strategic behavior. I call such a political system, which the second row in table 15.1 summarizes, bargained democracy.

Median democracy and bargained democracy have different strengths and weaknesses, as summarized in table 15.2. The median rule is stable, so referenda and single-purpose governments tend toward stability. In addition, everyone who votes contributes to determining the median, so referenda respond to voters. Besides these two strengths, median democracy has the weakness of obstructing trade across issues. Without trade, politics is inefficient relative to the preferences of citizens. In addition, referenda and single-purpose governments increase the number of elections, which can strain civic virtue. Oscar Wilde reputedly said, "The trouble with socialism is that it takes up too many evenings." Similarly, referenda and single-purpose governments absorb the resources and time of many talented people.

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3 This quote is often attributed to him, but my trusted reference librarian, Debby Kearney, could not find the sentence in his writing.
Conversely, by splicing functions and reducing the number of governments, bargained democracy demands less participation by citizens in elections, which conserves civic virtue. In addition, a multipurpose legislature facilitates bargaining. By trading across issues, politics can achieve efficiency relative to the preferences of citizens. In practice, however, political bargaining may not realize the best possibility. Indirect democracy requires citizens to monitor representatives, but each citizen has an incentive to free-ride on monitoring efforts by others. Imperfect monitoring by citizens enables their representatives to pursue objectives contrary to the interests of most voters.

Besides this agency problem, indirect democracy can provoke contests of distribution over the surplus from cooperation. A contest for redistribution wastes resources and can paralyze government. In markets, perfect competition forces everyone to trade at market prices, which solves the distribution problem. No one, however, has contrived a perfectly competitive mechanism to control the state’s natural monopoly powers. As long as a democratic constitution stops short of perfect political competition, a problem of distribution will persist. Self-interested rationality does not dictate how to divide the surplus from cooperation. The resulting destabilization of political coalitions constitutes the problem of democracy’s empty core.

I have explained that bargained democracy has the potential to outperform median democracy, and bargained democracy also risks performing worse than median democracy. For this reason, the optimal number of governments differs by place and time. Table 15.2 suggests how to adjust democracy in a particular country in light of actual performance. When elections pick faithful representatives who bargain successfully with each other, legislatures produce the laws and public goods that citizens want. Under these conditions, the constitution should consolidate power held by the national legislature. Conversely, when legislators do not serve the interests of citizens, legislatures produce unwanted laws and undesired public goods. Or when legislators cannot cooperate with each other, the legislature produces little law and few public goods. A state plagued by unsponsive officials or legislative paralysis should tilt toward median democracy. To tilt toward median democracy, the state should favor single-purpose governments, ballot initiatives, and referenda. The tilt toward median democracy must stop short of exhausting the citizens with too many elections.

### Table 15.2

<table>
<thead>
<tr>
<th></th>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Median democracy</td>
<td>responsive, stable</td>
<td>no trades, possibly exhausted citizens</td>
</tr>
<tr>
<td>Bargained democracy</td>
<td>possibly efficient</td>
<td>possibly unresponsive, possibly unstable</td>
</tr>
</tbody>
</table>
Table 15.2 has a special application to unresponsive administrators. When freed from control by voters, administrators engorge the bureaucracy or enrich themselves by corruption. The mechanical application of rules can reduce corruption and promote political control over administration, at the cost of inflexibility. By increasing the number of elections, the state can narrow and shorten the administrative hierarchy, thus reducing administration and increasing government. Assuming honest elections, increasing the number of elections can reduce corruption, while retaining flexibility.

**Treaty, Association, Federation—Optimal Relations between Governments**

The problem of the optimal number of governments focuses on the quantity of elections. A related problem, also analyzed in part 2, concerns the terms on which different governments relate to each other. Treaty, association, and confederation represent increasing levels of centralization. Optimal centralization partly depends on the character of the goods that the states must supply. For local public goods, a legal framework of free mobility allows citizens to sort themselves by preferences for local public goods. Given free mobility, states must satisfy the preferences of citizens in order to attract residents. Even without mobility, the right of communities to contract freely with governments for the supply of local public goods can make governments compete with each other. Free mobility and free contract ideally create competition among governments that increases efficiency in the supply of local public goods.

In addition to supplying local public goods, states also supply private law. The right of citizens to stipulate the state with jurisdiction over contracts can force governments to compete in supplying private law. Competition to supply private law promotes efficient government. Conversely, forced harmonization of law precludes competition among jurisdictions.

I have explained how competition among states improves the supply of local public goods and private law. Instead of competition, however, some problems of government require coordination or cooperation among states. Pure coordination problems merely require a framework for exchanging information. A treaty among states can establish the organization needed to exchange information. Beyond coordination, some public problems require cooperation. Sovereign states cooperate under unanimity rule, under which the most independent regions and localities can demand the best terms. As summarized in table 15.3, unanimity rule strengthens the bargaining power of the party who least needs collective action. Alternatively, federal states cooperate under some form of majority rule. Majority rule strengthens the bargaining power of the parties inside the national coalition that governs the country.

I explained how unanimity rule and majority rule differ with respect to distribution. In an ideal world of zero transaction costs, the form of cooperation
TABLE 15.3
Sovereign v. Federal

<table>
<thead>
<tr>
<th>Constitutional Form</th>
<th>Empowered Group</th>
<th>Efficiency Problem</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unanimity rule</td>
<td>sovereign states</td>
<td>least need for collective action</td>
</tr>
<tr>
<td>Majority rule</td>
<td>federal system</td>
<td>national coalition</td>
</tr>
</tbody>
</table>

TABLE 15.4
Relations among States

<table>
<thead>
<tr>
<th>Public Need</th>
<th>Incentive Mechanism for States</th>
<th>Legal Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private law of contracts</td>
<td>Competition for jurisdiction</td>
<td>Right to stipulate jurisdiction in contracts</td>
</tr>
<tr>
<td>Local public goods</td>
<td>Competition for residents and public goods contracts</td>
<td>Individual’s right of mobility and locality’s freedom of contract</td>
</tr>
<tr>
<td>Coordinate among states</td>
<td>Information exchange</td>
<td>Treaty</td>
</tr>
<tr>
<td>Cooperation by few states</td>
<td>Unanimity rule</td>
<td>Association</td>
</tr>
<tr>
<td>Cooperation by many states</td>
<td>Majority rule</td>
<td>Federation</td>
</tr>
</tbody>
</table>

among regional or local governments, unanimity rule creates a problem of holdouts. Small groups usually solve the problem of holdouts, whereas a solution usually eludes large groups. To solve the problem of holdouts, a large group must switch to majority rule, which usually creates another problem. Under majority rule, the parties inside the national coalition can shift the costs of government to the parties outside of it. So majority rule creates opportunities for politicians to waste resources in a contest of distribution. The last column in table 15.3 summarizes these conclusions about efficiency.

Combining the results in table 15.2 and 15.3, table 15.4 suggests how to adjust intergovernmental relations in light of actual performance by states. To improve private law arising from contracts, lower the obstacles to stipulating jurisdiction in contracts. To improve the supply of local public goods, lower the cost of mobility to citizens and remove obstacles to communities contracting with governments. To improve coordination among states, create a treaty organization for the exchange of information. To improve cooperation among a few states,
needed collective action, reduce the scope of unanimity rule and increase the scope of majority rule. Conversely, when states compete to redistribute wealth through control of the central government, increase the scope of unanimity rule and reduce the scope of majority rule.

**How Many Branches?—Optimal Division of Powers within a Government**

The analysis of the optimal number of governments and the optimal relations between governments in part 2 of this book views each state externally. Part 3, however, turns to the internal structure of government and considers the division of powers among its branches. To summarize the results, first contrast unification and fragmentation of political power. Proportional representation fragments the legislature's power by encouraging many political parties, whereas single-district winner-take-all elections unify power by consolidating parties. Bicameralism also fragments legislative power, whereas unicameralism unifies legislative power. Indirect election of the prime minister unifies legislative and executive power, whereas direct election of the president fragments legislative and executive power.

Fragmenting power requires government to proceed by bargains, which I have already called "bargained democracy." By contrast, unifying power can enable the executive to proceed by commands, which I call "command democracy." In the purest form of bargained democracy, the legislature dominates, whereas the executive dominates in command democracy. Table 15.5 summarizes this contrast.

Table 15.6 summarizes the strengths and weaknesses of bargained democracy and command democracy. As explained, bargaining can aggregate political preferences efficiently, or, alternatively, failed bargains can destabilize politics. In contrast, the executive in a command democracy can formulate a consistent plan of action and proceed decisively. Like the central planner under communism, however, the executive in a political system lacks the information required to match public goods and the preferences of citizens. Under the best conditions, insufficient information makes a strong executive unresponsive, and under the
Table 15.6

<table>
<thead>
<tr>
<th></th>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bargained democracy</td>
<td>possibly efficient</td>
<td>possibly unstable</td>
</tr>
<tr>
<td>Command democracy</td>
<td>decisive</td>
<td>unresponsive, possibly dictatorial</td>
</tr>
</tbody>
</table>

worst conditions a strong executive ends democracy by eliminating political competition.

Tables 15.5 and 15.6 suggest how to adjust the allocation of internal power in light of actual performance by a state. When failed bargains cause instability, unify power by such measures as single-district winner-take-all elections or by strengthening the dominant house of the legislature. Alternatively, when the executive threatens the rule of law, fragment power in order to move from command democracy toward bargained democracy. Implement the change to bargained democracy by adopting proportional representation, dividing power between two equal houses of the legislature, or, possibly, shifting power from prime minister to president. (The change from indirect to direct election of the executive has uncertain effects on the executive’s power.)*

Now I turn from politics to administration. Proceeding down through the state hierarchy, politics intersects administration where political appointment ends and civil-service jobs begin. At the top of the hierarchy, political control makes administration respond to the electorate. Below the top, however, independence of the civil service keeps administration honest.

Chapters 4 and 7 develop theories of administration that imply some prescriptions to increase responsiveness and reduce corruption in administration. To increase responsiveness, decrease the breadth and depth of bureaucracy by increasing the number of elections; impose uniform procedures on administrators, thus lowering the transaction costs of review by official bodies; and change the way courts, legislative committees, and other official bodies review the performance of administrators. A shift from cooperative oversight to unilateral oversight by several official bodies can force civil servants to respond more to elected officials and judges.

To reduce corruption in administration, decrease political appointments and increase civil-service jobs; reduce the discretion of officials by making them follow rules; adopt uniform procedures that make administration more transparent to citizens; and reduce the depth and breadth of administration by increasing the number of elections.

*Being outside the legislature, a president typically suffers a disadvantage relative to a prime minister in controlling the legislature. A directly elected president, however, enjoys a popular mandate that the prime minister lacks. The question is whether a popular mandate strengthens the executive’s
TABLE 15.7
Problems and Solutions for Administration and Courts

<table>
<thead>
<tr>
<th>Public Problem</th>
<th>Legal Solution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unresponsive administration</td>
<td>More elections; uniform procedures; unilateral oversight</td>
</tr>
<tr>
<td>Corrupt administration</td>
<td>Fewer patronage jobs; more rules; uniform procedures; more elections</td>
</tr>
<tr>
<td>Insufficient rule of law</td>
<td>Judicial civil service or once-for-all political appointments of judges</td>
</tr>
<tr>
<td>Weak courts</td>
<td>Constitutional review by courts of general jurisdiction; divide legislative power; judicial review of administrative procedures</td>
</tr>
</tbody>
</table>

Now I turn from administrators to courts. Independent courts secure the rule of law, which enables politicians to make credible commitments. To secure independence, either create a judicial civil service as in most civil-law countries, or else allow once-for-all political appointments as in the U.S. federal courts. By one means or the other, prevent politicians from influencing the salaries or promotions of individual judges.

Given independent courts, the extent of their power responds to several variables. To increase (decrease) the discretionary power of the court to interpret law, give (take away) the power of constitutional review to courts of general jurisdiction and divide power among more (fewer) branches of government that must cooperate to enact new statutes. To increase (decrease) the power of courts over civil servants, allow (prohibit) courts to impose procedures on administrators. Administrators will respond by reducing the burdened activity, and the extent of the decrease usually depends on the administrators’ ability to substitute another public good in place of the one burdened by more costly procedures. When substitution is easy politically and technically, imposing a more costly procedure causes a large decrease in the supply of the good in question. Table 15.7 summarizes these prescriptions for administration and courts.

**Protecting Individuals—Optimal Rights**

Having analyzed the allocation of powers to officials in parts 2 and 3, part 4 turns to the constitutional rights of individuals. The people who enjoy rights usually value them, and a good constitution responds to these valuations. For affluent people, basic liberties often trump other values, whereas marginal liberties trade off with other values, including wealth. These facts suggest that the
TABLE 15.8
Problems and Solutions Involving Constitutional Rights

<table>
<thead>
<tr>
<th>Public Problem</th>
<th>Legal Solution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property rights</td>
<td>Redistributive contests</td>
</tr>
<tr>
<td></td>
<td>Restrict takings and allow general taxes</td>
</tr>
<tr>
<td></td>
<td>Private activity harms the public</td>
</tr>
<tr>
<td></td>
<td>Elasticity principle; TDRs</td>
</tr>
<tr>
<td></td>
<td>Bargaining with state</td>
</tr>
<tr>
<td></td>
<td>Duty to mitigate; offset by mutual agreement</td>
</tr>
<tr>
<td>Speech rights</td>
<td>Undersupply of ideas and information</td>
</tr>
<tr>
<td></td>
<td>Free speech and intellectual property protection</td>
</tr>
<tr>
<td></td>
<td>Organizations restrict speech</td>
</tr>
<tr>
<td></td>
<td>Mobility principle for speech restrictions</td>
</tr>
<tr>
<td></td>
<td>False information causes harm</td>
</tr>
<tr>
<td></td>
<td>Balancing test for libel</td>
</tr>
<tr>
<td>Civil rights</td>
<td>Discrimination by a social cartel</td>
</tr>
<tr>
<td></td>
<td>Prohibit discriminatory laws; nonenforcement of</td>
</tr>
<tr>
<td></td>
<td>discriminatory contracts</td>
</tr>
<tr>
<td></td>
<td>Rationally prejudicial signals</td>
</tr>
<tr>
<td></td>
<td>Increase market information</td>
</tr>
<tr>
<td></td>
<td>Unstable integration; racial flight</td>
</tr>
<tr>
<td></td>
<td>Ceiling quotas; tax subsidies; transferable rights</td>
</tr>
</tbody>
</table>

of constitutional rights to the people who enjoy them, focusing on property rights, free speech, and civil rights.

By giving people freedom over things, property law promotes exchange and internalizes the benefits of efficient resource use. Many politicians, however, want to expropriate their enemies’ wealth and restrain their friends’ competitors. A constitution can dampen contests of redistribution by removing some disputes from ordinary politics. A good constitution channels the politics of redistribution away from takings and into broad taxes. For example, a constitution can guarantee the rights of property and contract that keep markets free, while allowing politics to determine the level of taxation.

Entangling uses by property owners cause externalities. When externalities involve small numbers of contiguous owners, they can usually solve the problem themselves through bargaining and social norms. When externalities involve large numbers of owners, however, transaction costs obstruct bargaining and the evolution of social norms. In these circumstances, the state often takes measures to control externalities. The courts must decide whether these measures regulate property, which requires no compensation of owners by the state, or takes property, which requires compensation of owners by the state. According
An elastic response by the state and an inelastic response by owners commend a high level of compensation, whereas an inelastic response by the state and an elastic response by owners commend a low level of compensation.

In the minds of most administrators, the command-and-control approach, which has been discredited for most forms of regulation, remains the only possibility for land-use planning. With more imagination, transferable development rights could supplement or replace conventional land-use restrictions, including zoning. TDRs reduce the information required for rational planning and channel the efforts of owners into market activities rather than political activities.

Developers often have to bargain with the state over permits. If the state can require the developer to offset the public harm from development, then the developer's bargaining position is weak. The state may exploit this weakness by extracting the full surplus from the project in exchange for the required building permit. To strengthen the owner's bargaining power, give owners the right to develop provided that they mitigate the public harm from development. Given this right, however, allow owners and the state to bargain to an agreement substituting an offset for mitigation.

Turning from property to speech, note that speech transmits beneficial ideas and useful information that markets undersupply. Regulating speech promotes monopoly, which aggravates the shortage of ideas and information. Specifically, restricting political speech threatens democracy and restricting commercial speech harms product markets. Conversely, effective constitutional protection of speech prevents the state from aggravating the natural shortage of ideas and information in markets and politics. Unlike speech that provides beneficial ideas and information, some speech harms other people, such as involuntary exposure of people to pornography. In principle, a pornography tax could internalize this externality.

Many organizations try to increase their effectiveness by restricting the speech of members. Each organization strikes a different balance between restrictions on speech and larger rewards from belonging to a more effective organization. Competition for members allows individuals to strike their preferred balance by choosing among organizations. As competition lowers the cost of exiting from an organization, members can escape unwanted restrictions more easily, so courts have less reason to scrutinize restrictions on speech of members and more reason to defer to the balance struck by individuals. Conversely, as monopoly power raises the cost of exiting from an organization, courts have more reason to scrutinize restrictions on speech of members. The mobility principle asserts that courts should scrutinize organizational restrictions on members' speech in proportion to the cost of leaving the organization.

A free market for ideas stimulates beneficial ideas and undermines harmful ideas. Consequently, no liability should attach to the invention and promulgation of bad ideas. In this respect, false assertions differ from bad ideas. A person who wishes to make an assertion should balance the expected gain from its truth...
Now I turn from free speech to civil rights. Perfect competition usually eliminates discrimination or makes the discriminators bear its cost. Statistical studies often conclude, however, that victims pay for persistent economic discrimination in the United States. If these statistics tell the truth, then civil rights laws should correct market failures that cause harmful discrimination.

Monopoly power, asymmetric information, and externalities are three fundamental types of market failures that can cause harmful discrimination. Like any business cartel, a social group gains an advantage by blocking competition from other people, as when an ethnic group reserves the best jobs for its own members. Like a business cartel, however, a social cartel suffers from instability. Cartel members who "cheat" by surreptitiously breaking its rules harm their group while benefiting themselves and outsiders. To survive, a social cartel must use social norms or public laws to suppress cheating by members. Destabilizing social cartels requires the same techniques that antitrust law uses against business cartels. Specifically, courts should strike down discriminatory laws and refuse to enforce discriminatory contracts.

Another type of problem concerns information-based discrimination. Businesses base many decisions on statistical inferences. Irrational prejudice, which competition punishes, consists of making decisions about individuals based on false correlation between personal traits and average economic behavior. Rational prejudice, which competition rewards, consists of making decisions about individuals based on true correlation between personal traits and average economic behavior. To combat rational prejudice, the state should increase information so decision makers no longer rely on objectionable inferences from statistical averages.

Besides social cartels and discriminatory signals, the attitudes of people toward each other can create externalities that disrupt markets. For example, a continuous distribution of attitudes toward mixing with other races can destabilize an integrated environment, causing racial flight. In principle, externalities can be corrected by ceiling quotas, tax subsidies, or transferable rights such as school vouchers.

Motives and the Institutions of Democracy

To make the preceding predictions and prescriptions, I attempt to understand politics as a strategic interaction among self-interested people. This approach has a long history, going back at least to Machiavelli and Hobbes. Alternatively, political theory can proceed by assuming that officials directly pursue moral values such as justice, fairness, or the public interest. The normative approach goes back at least to Plato's Republic and it continues today as exemplified by the writings of Rawls, Habermas, and Thompson.

While the normative approach focuses on how officials ought to act, its use-
lyzing norms is useful for predicting and influencing the behavior of officials. Conversely, if norms do not affect officials, then analyzing norms is useless for predicting or influencing the behavior of officials. To explain why strategic theory is more useful than normative theory for understanding democracy, I will compare motives and democratic institutions.

**Interests**

Democracy is a system of popular competition for office. Successful politicians aim to win elections. Some founders of the United States hoped that democratic competition would select a “natural aristocracy” to lead. Most successful politicians, however, resemble power brokers more than aristocrats. Industrialists want subsidies, artists want grants, students want fellowships, parents want tax deductions, the elderly want pensions, and so forth. To obtain political influence, these individuals must organize. Organized interests look to their own advantages, not to the public good.

To create a winning coalition of voters, politicians must bargain and make deals that give organized interests the laws and public goods that they most desire. From this perspective, the real work of the legislature involves bargaining, whereas debates among politicians about the public interest are mostly rhetoric. Perhaps the democratic process occasionally shakes loose from the constraints of self-interest, but these moments occur seldom, if ever. Most state officials try to do well and a few try to do right.

**Reason**

I have argued that electoral competition selects politicians who pursue power most skillfully. In addition to competitive government, democracy encompasses the rule of law, which requires insulating judges from political pressure. Instead of satisfying interests, courts evaluate arguments. Courts are ideally moved by reasons, especially reasons about fairness, morality, and the public interest. Insofar as these reasons move courts, normative theories are useful to predict, and influence, the behavior of courts.

As summarized in the first and second rows of table 15.9, legislators especially bargain over interests, and courts especially debate over reasons. Shifting lawmaking power from legislators to judges, consequently, tilts government toward reason and away from interests.

6 *Jefferson* wrote to Adams, “I agree with you that there is a natural aristocracy among men. The grounds of this are virtue and talents. ... May we not even say that that form of government is the best which provides for a pure selection of these natural aristoi into the offices of government?" Letter of 28 October 1813, in *Jefferson* 1984, pp. 1305-06.

7 Ackerman has proposed that special moments occur in the political history of a country when people can rise above the normal politics of self-interest and create constitutional provisions from
A good constitution tilts without tumbling over. To appreciate the risk of tumbling over, consider Plato’s great meditation on justice, *The Republic*, which stands near the beginning of Western political philosophy. To make government respond to reason, Plato’s constitution gives the most power to the best philosopher. The philosopher-king in Plato’s republic has no use for competitive elections. In reality, however, power without competition corrupts ambition. If a state organized by Plato’s prescription, the philosopher-king would quickly cease being a philosopher and begin acting like a king.

Besides restraining power, elections provide officials with information about the political preferences of citizens. The absence of elections in Plato’s republic deprives officials of information about the laws and public goods that citizens want. Instead of responding to citizens, Plato’s philosopher-king regulates the details of their lives, even controlling marriages through the rationalizing power of a great lie. In Plato’s view, the philosopher-king perceives the forms of reason and thereby understands the requirements of justice. This conception of lawmaking, which represents the political conceit of intellectuals, disastrously overestimates the power of reason and underestimates the power of empirical knowledge.

Plato’s *Republic* exhibits the best and worst that philosophy offers constitutional law. As primary lawmakers, judges suffer from the same weaknesses as Plato’s philosopher-king. Distancing judges from the pressures of competitive elections removes the motivation and information needed to satisfy the preferences of citizens.

**Passion**

Having considered the motives of politicians and judges, I turn to citizens. A single vote seldom influences the outcome of a large election. Large elections

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**Table 15.9**

<table>
<thead>
<tr>
<th>Motive</th>
<th>Process</th>
<th>Institution</th>
</tr>
</thead>
<tbody>
<tr>
<td>interest</td>
<td>bargain</td>
<td>legislature</td>
</tr>
<tr>
<td>reason</td>
<td>debate</td>
<td>court</td>
</tr>
<tr>
<td>passion</td>
<td>oratory</td>
<td>campaign</td>
</tr>
<tr>
<td>will</td>
<td>commands</td>
<td>executive</td>
</tr>
</tbody>
</table>

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*Reproduction was to be regulated through the “myth of the metals,” according to which different people are made from different metals that differ in their value. In his history of philosophy, Bertrand Russell says that “compulsory acceptance of such myths is incompatible with philosophy, and involves a kind of education which stunts intelligence.” See Russell 1945, chapter 14, “Plato’s Utopia,” p. 113.*

*Bertrand Russell wrote in his history of philosophy that he would treat Plato “with as little*
and the secret ballot eliminate material sacrifice by a citizen who votes his conscience rather than his interests. Given low costs, citizens enjoy expressing political values, rather like people enjoy telling others how to live. As voters, citizens have mixed motives that combine self-interest and a conception of the public interest. Sometimes a person's conception of the public interest merely rationalizes his self-interest. Sometimes, however, self-interest and a person's conception of the public interest drift apart. To the extent that citizens vote against their interests, normative theories presumably have a role in explaining voting.

Like most judges, citizens are free from electoral competition. Unlike most judges, however, few citizens carefully listen to lengthy arguments and deliberate before casting a vote. Furthermore, ordinary citizens do not have training in law and government comparable to that of judges. Inchoate feeling presumably influences citizens more than judges, whereas explicit reasons presumably influence judges more than citizens. Understanding these facts, politicians use oratory and symbols to arouse feelings and influence voters in electoral campaigns, as indicated in the third row of table 15.9.

**Will**

Since passions are unstable, a mature adult needs the strength of will to override momentary impulses. Strength of will enables a person to pursue enduring goals consistently. Like a person, a state needs to pursue enduring goals consistently. This ability especially comes from the political leadership provided by the executive. The executive leads by his ability to command civil servants and the members of his own party. As indicated by the last row in table 15.9, the executive especially supplies will to the state.

By shifting lawmaking power from legislators to the executive, a constitution can tilt toward will and away from interests. In times of war or great crisis, citizens narrow their goals for the nation. In an emergency, a democracy that eschews dictatorship sometimes invests the executive with emergency powers.

**Democracy's Superiority**

Table 15.9 contrasts the role of interest, reason, passion, and will in democratic politics. To the extent that bargains matter in politics, interests must be important, so the legislature needs power. To the extent that debate matters in politics, reasons must be important, so the courts need power. To the extent that oratory matters in politics, passions must be important, so campaigns influence politics. To the extent that commands matter in politics, will must be important, so the executive needs power.

The superiority of democracy, I believe, rests on an institutional framework that makes law respond especially to interests and gives lawmaking power to the legislature. The interests of people in order, liberty, and prosperity provide the
most reliable motivation for political cooperation. Democracy responds to these interests by providing citizens with the laws and public goods that they prefer.

Conversely, too much influence on lawmaking by reason, passion, or will can frustrate citizens. Since reason is abstract, judges are too remote from citizens to be the principle lawmakers. Since passion is unstable, the law must constrain demagogues by channeling political campaigns. Since will is instrumental, the citizens must give ends to the executive rather than have the executive impose ends on citizens.

CONCLUSION

I used strategic theory to make prescriptions for democracy. Now I conclude by discussing the limits of strategic theory and how to transcend them.

Better Data and More Applications

Strategic theory explains the logic of interaction among rational people. Replacing intuition with logic often reveals causal connections that no one previously articulated. Logic, however, guarantees consistency, not predictive accuracy. Predictive accuracy comes from empirical validity. How valid is constitutional law and economics?

"Not very valid" is the answer suggested by two quips. "In legal scholarship, one anecdote is empirical evidence and two anecdotes are data." "Proving the efficiency of a legal institution by an economic model resembles shooting an arrow into a tree and then drawing a bull's eye around it." While these quips have enough truth to sting, they underestimate the empirical validity of the models in this book. This book builds models from stylized legal facts, makes predictions from the models, compares the predictions to facts, and then revises the models. Thus facts feed back into models.

As scientific method, empirical feedback falls short of testing hypotheses. Testing hypotheses involves making predictions from models, then confirming or disconfirming the predictions by statistics. The economic analysis of constitutional law currently lacks the data needed to test its hypotheses. The desire to test hypotheses is not merely physics envy, but the aspiration for a science of government. Testing hypotheses gives confidence in results that cannot be obtained in another way. Finding the data to test legal hypotheses, however, requires too much donkey work for most legal scholars. In addition, relatively few constitutional scholars have the necessary statistical training. Hypothesis testing in constitutional law awaits improved government statistics and a new generation of constitutional scholars with mastery over empirical methods. At this stage in its development, the field of constitutional law and economics must draw on stylized facts and informal observations to ground its theories. (J. S. Mill believed that economics necessarily has this character.\textsuperscript{11})
In addition to having insufficient data, constitutional law and economics suffers from a deficiency in the level of research. Influencing disputes in constitutional law requires research at the same level of generality as the issues posed in court cases. In fact, most research in constitutional law and economics proceeds at a higher level of abstraction than arguments in legal disputes. Scholarly research is thin at the level where judges and other officials make decisions. I hope that this book stimulates concrete, applied research aimed at influencing constitutional law.

By advocating empirical research and applications, I have offered a conventional prescription to improve law and economics. Next I turn to prescriptions that economists find controversial or unpalatable. Specifically, I will discuss modeling more diverse motives than interests.

The Internal Point of View

Why obey the law? Oliver Wendell Holmes urged scholars to consider the law from the viewpoint of a "bad man," who obeys the law because the price of disobeying is too high. The threat of sanctions deters bad people from disobeying the law. Conventional economics follows the advice of Holmes and views laws externally like prices.

Even though people often experience law as coercive, when asked why they obey law, most Americans give moral reasons. The form of these reasons often predicts the person’s attitudes toward law (Tyler 1990). If this psychological research is accurate, most Americans obey the law out of respect. Understanding their behavior requires considering the law from the viewpoint of a "good man," who internalizes the law and obeys it out of respect.

Perhaps the "good man" theory explains why most people obey the law most of the time, whereas the "bad man" theory explains the behavior of actors who balance on the edge between obeying and disobeying the law. In other words, the "good man" theory explains the average person’s behavior and the "bad man" theory explains the marginal person’s behavior.

If people were angels who internalized law perfectly, state coercion would be unnecessary. Although people are hardly angels, even imperfect internalization reduces the need for state coercion. Given the inverse relationship between internalization and coercion, the long tradition in economics that admires limited government should also admire internalization. Beyond government, respect for the law enhances the efficiency of markets that link strangers in a decentralized economy.

his views differ sharply from those of Milton Friedman, who argued that the realism of assumptions is irrelevant to building economic models (Friedman 1953).

12 Holmes 1897. “If you want to know the law and nothing else, you must look at it as a bad man, who cares only for the material consequences which such knowledge enables him to predict, not as a good one, who finds his reasons for conduct, whether inside the law or outside of it, in the vaguer sanctions of conscience.”

13 MacCormick 1998 stresses the "heteronomy of the will" in politics.
The contrast between the external and internal viewpoint toward law relates to the contrast between prices and preferences in economics. An economist analyzes an external obligation as a price and an internal obligation as a preference. In economics, a person “prefers” whatever he is willing to pay for, including obeying the law. The price can be denominated in money, effort, time, or any other scarce resource. The amount the person is willing to pay measures the intensity of the preference.

From a psychological viewpoint, however, respect for the law does not feel like a preference for asparagus or waterskiing. Internalized obligations differ markedly from conventional economic preferences. The difference is so great that noneconomists balk at calling so many different things “preferences.”

The important point, however, does not concern feelings or semantics. Rather, the important point concerns a difficulty in applying the economic theory of preferences to respect for the law. Most people value wealth and power, and they face obstacles to fulfilling their desires. In contrast, few people value poverty and vulnerability, and these desires are easily fulfilled. Competition ensures that successful politicians have a sharp, unsatisfied desire for power and wealth. Consequently, the assumption that each politician wants more power and wealth is a good starting point for political theory.

Respect for the law, however, differs from one country to another. Aristotle thought that good government makes good citizens. Political institutions presumably explain part of the variation. To illustrate, democracy requires citizens to participate in government, which may increase their respect for law. A political theory should explain why some political institutions create respect for law and other political institutions create cynicism.

Insofar as political institutions affect the respect of citizens for law, political theory should explain respect for law. An explanation requires a theory of how people acquire and lose respect for law. Developing such a theory is especially urgent for advocates of limited government and a decentralized economy. Unfortunately, conventional economics takes tastes as given. No accepted theory of endogenous preferences exists in economics. Consequently, this book offers no explanation of how a constitution can create respect for the law. For example, I offer a mixed theory of voting by citizens that combines self-interest and a conception of the public interest. I do not, however, offer an explanation of why some citizens internalize a particular conception of the public interest.

A good political theory explains, not assumes, respect for law. Being based on game theory, this book suffers from the absence of an explanation of respect for law. Unlike conventional economists, however, I do not think that modeling respect for law as a “preference” excuses me from explaining it. I will conclude in Washington in March 1999 by Institutional Reform and the Informal Sector. The conference papers will be published.

15 Aristotle wrote, “... Legislators make the citizens good by forming habits in them, and this is the wish for every legislator, and those who do not effect it miss their mark, and it is in this that a good constitution differs from a bad one” (Nicomachean Ethics, 1103b5). I witnessed a dramatic
with a few remarks sketching how I eventually hope to overcome this weakness in theory.

**Toward a Theory of Internalization**

Constitutional scholars, lawmakers, and judges vigorously debate about the values that people *should* have. Public debate does not take preferences as given. Instead of implementing values, public debate often tries to change them. In these debates, scholars offer reasons that justify one set of political principles rather than another. This is a central task of political and moral philosophy. To illustrate, Bruce Ackerman argues that under liberal restrictions on discourse, claims supported by neutral reasons yield a unique set of distributive principles.¹⁶

By offering reasons for values, philosophy offers a rational basis for internalization. Unlike philosophy, psychological theories such as behaviorism and Freudianism explain internalization by irrational processes. Social conditioning, habit formation, and transference are often inaccessible to thought or choice. "Depth psychology" searches for the unconscious and involuntary foundation of articulated values. Some modern linguists take a similar approach through the study of metaphors (Lakoff and Johnson 1980).

Economics is more rational than psychology and more predictive than philosophy. Economics should contribute to understanding respect for law by developing a theory that is rational and predictive. I have some idea of how to retain the core assumptions of economics and extend them to encompass the internal viewpoint toward law. In games, the players sometimes deliberately worsen the payoff that they will receive in the future from choosing a particular strategy. Deliberately worsening your own payoff from a particular strategy commits the player to choosing another strategy. To illustrate, an advancing army commits to the offense by burning the bridges behind it. Burning the bridges increases the absolute cost of retreating, thus increasing the relative gain from advancing.

Similarly, internalizing a social norm attaches a personal penalty to the forbidden act. The personal penalty increases the absolute cost from doing wrong, thus increasing the relative gain from doing right. In most cooperative activities, people prefer partners with moral commitments. Consequently, a rational person can gain from making moral commitments in cooperative games. A rationally self-interested person with the power to make moral commitments would internalize a norm when the commitment conveys an advantage. (I call such commitments *Pareto self-improvements*.)¹⁷

Many people view respect for law and allegiance to the state as requirements for being a good citizen. Being perceived as a good citizen conveys advan-
tages on a person, in particular the advantages of participating in cooperative ventures organized according to democratic social norms. Perhaps a democratic constitution and a democratic culture convey advantages on people who internalize democratic ideals. In this way, democracy makes good citizens. (In my language, internalizing respect for law is a Pareto self-improvement.)

Internalization implies the possibility of alternative selves. Much of personality development concerns choosing whom to become. A complete theory along these lines would explain how democracy forms the self in which an actor has an interest.

A related point concerns self-expression. I explained that signaling moral commitment conveys an advantage by increasing trust as needed for cooperation. Moral commitment, however, can be fake or genuine. For most people, a cool lie comes easier than a fake emotion. So emotional expression plays a role in certifying genuine moral commitment (Frank 1988). In politics, the symbols whose manipulation arouses passion often concern loyalties to ethnic groups, social classes, or localities. An economic theory of expressive law, however, is in its infancy.

The role of emotion in expressing internalized values makes law and politics relatively hot. The strategic theory of democracy, however, is relatively cool. Extending strategic theory to the internal viewpoint might warm people to constitutional law and economics.

Earlier I stated that democracy's superiority over other forms of government rests partly upon legal institutions that respond to the interests of citizens. In addition, part of democracy's superiority rests upon self-reinforcement. Specifically, democracy enlists the support of citizens for government, and participation of citizens in government improves civic morality. When good citizens make good government and good government makes good citizens, democracy reinforces itself.

Some social theorists like Locke aim for balance, whereas other theorists like Hobbes aim for purity. The strategic theory of democracy developed in this book relies on the positive methodology of individual rationality and the normative standard of preference satisfaction. I have attempted to work these ideas pure as applied to constitutional democracy. I have argued that strategic

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18 Ibid.
19 Emphasizing the development of one aspect of a person rather than another requires self-control. In contrast, the standard economic model of decision making does not encompass the problem of self-control, so the faculty of the will is not modeled. The economic analysis of law has made little use of the economics of self-control and self-monitoring. I have written two papers on this subject. See Cooter 1991c and Cooter 1998c.
20 The political process of inventing tests of loyalty to social groups has been called "ethnification" (Kuran 1998).
22 Rawls argues that a more just state has an advantage in competition with less just states. Rawls
theory encompasses the larger part of democratic politics and philosophical theories encompass a smaller part of it. By working strategic theory pure, I have omitted part of constitutional theory, but I hope to correct this omission in the future by helping economics to assimilate the internal point of view toward law.