

Prof. Bryan Caplan
bcaplan@gmu.edu
<http://www.bcaplan.com>
Econ 854

Week 13: Constitutions

- I. The Comparative Institutions Approach Revisited
 - A. Remember the Emperor's tale?
 - B. After a full semester of public choice, we are now in a much better position to step back and compare institutions.
 - C. Dictatorship has obvious problems. How do the problems of democracy compare?
 - D. Economically literate defenders of democracy typically focus on government's special ability to supply public goods. After analyzing how democracy actually works, what can we say about this?
 - E. If people voted rationally and instrumentally, the public goods argument makes a great deal of sense.
 - F. However, since voting is largely expressive and not instrumental, public goods are supplied only by coincidence.
 1. Ex: National defense may have expressive as well as instrumental value.
 - G. But: Expressive voting is likely to lead to government involvement in a wide array of "feel-good" issues that have nothing to do with public goods.
 1. Care of the old
 2. Health
 3. Education
 - H. Similarly, whenever voters hold systematically mistaken beliefs, we are likely to see government wasting resources or being actively counter-productive.
 1. International trade
 2. Price controls
 3. Labor market regulation
 - I. All this adds up to an efficiency case for limiting the scope of democracy in order to keep "political pollution" under control.
 - J. Still, if dictatorship and democracy are our only choices, democracy seems like the lesser evil.
- II. Alternatives to Democracy and Dictatorship
 - A. Is democracy the only alternative to dictatorship? Most countries that we call "democracies" have *many* undemocratic elements, including:
 1. Supermajority rules
 2. Division of powers
 3. Limitations on the *scope* of democracy
 4. Federalism

5. Franchise restrictions – most notably the restriction that only citizens get to vote!
 6. Plural voting
 7. Judicial review
 8. Disproportionate representation
 9. Lifetime appointments
 10. More?
- B. Non-economists often insist, “This is a republic, not a democracy.” Strictly speaking, they’re right, even if unpopular restrictions on democracy tend to disappear.
1. Alternate formulation: “There are many different kinds of democracy.”
- C. Whether or not you call them “democratic,” couldn’t many of these restrictions mitigate democracy’s political failures?
- D. Ex: Supermajority rules (2/3 vote for price controls), limitations on the scope of democracy (“Congress shall pass no law infringing the freedom of production and trade”), and federalism could all mitigate anti-market bias.
- E. Ex: Giving two votes to college grads could mitigate anti-foreign bias.
- F. Ex: How about giving the CEA veto power over trade restrictions?
- G. More examples?
- III. Constitutional Reform and Endogenous Institutions
- A. Direct democracy rarely prevails in a pure form. Constitutional restrictions are all around us.
- B. These observations lead many people in public choice – most prominently, James Buchanan – to advocate constitutional reforms to improve upon the status quo.
- C. Example: 2/3 rule for spending. Perhaps then, pork barrel projects will fail, and only genuine public goods will receive funding.
- D. Problem: It seems like any public choice problem that afflicts day-to-day democracy will afflict constitutional choice as well.
- E. In other words, constitutions are *endogenous institutions*. They are a product of the same forces that generate other social outcomes, and no easier to change.
1. French/U.S. switch thought experiment.
- F. Some proposed constitutional amendments have no obvious impact on policy. These are relatively easy to pass, but what's the point?
- G. Other proposed constitutional amendments would obviously affect policy. These are hard to pass because the policies that currently exist tend to be popular.
- H. Note: This doesn’t mean that direct democracy always prevails, just that invoking “constitutional changes” as a solution to problems with the status quo is probably wishful thinking.
- IV. Are Constitutional Politics Different?

- A. Still, Buchanan and others insist that constitutional politics *are* different. Their central argument:
 - B. Constitutional politics operates behind a real (not merely hypothetical) “veil of ignorance.” This leads people to *selfishly* favor socially efficient policies.
 - 1. Buchanan’s favorite example: Auto accident liability rules. At the constitutional level, no one knows whether he’ll be a plaintiff or defendant, so we can get unanimous (or “virtually unanimous”) support for efficient policies.
 - C. This whole argument rests on the discredited SIVH, but it fails even on its own terms. There may be *some* constitutional rules where a veil of ignorance applies (though even Buchanan’s favorite example overlooks lawyers). But most constitutional rules are about *permanently locking in existing political advantages*.
 - D. Consider a few examples from the U.S. Constitution. Cui bono ex ante?
 - 1. The purpose of the Senate is to permanently give small states disproportionate influence.
 - 2. The purpose of the slave trade provision is to make sure that the slave trade remains legal until 1808.
 - 3. The purpose of the three-fifths compromise is to reduce the total influence of the South, but increase the influence of Southern whites.
 - E. Or consider modern some Constitutional decisions. Cui bono ex ante?
 - 1. The purpose of court rulings on religion is to prevent the religious majority from doing what it wants to the secular minority.
 - 2. The purpose of court rulings on abortion is to prevent states with pro-life majorities from restricting abortion.
 - 3. Others?
 - F. In each of these cases, it is obvious ex ante who will benefit and who will lose. The point is to reassure the winners of today that they will continue to get their way even if political conditions change to their disadvantage.
 - G. In “Before Public Choice,” Buchanan freely admits that social contract theory is a “myth” designed to “rationalize” the status quo. Exactly.
 - H. Rebuttals?
- V. Futarchy
- A. The most original and thoughtful suggestion for constitutional change in decades, if not centuries: Robin Hanson’s “futarchy.”
 - B. Background: Empirically, prediction markets (a.k.a. betting markets) are the best way to estimate the future. They are the turbo-powered version of “Put up or shut up.”

- C. Any question that eventually has a verifiable answer can be turned into a financial instrument – and its market price will efficiently aggregate all available information.
- D. This includes *contingent* instruments such as...
1. A stock price conditional on firing the CEO.
 2. The unemployment rate conditional on Obama winning.
 3. Terrorism deaths conditional on invading Iraq.
 4. Tax rates in 2020 conditional on TARP.
- E. Do betting markets give perverse incentives to make bad things happen? We rarely worry about this for traditional financial instruments, and in any case there is a simple solution: Register the bettors, and/or cap the bets.
1. 9/11 Commission found no evidence that anyone used prior knowledge of the attacks to profit.
- F. Do betting markets encourage manipulation to mislead people using the market price to make decisions? No. Manipulation just provokes arbitrage. See the Hanson-Oprea experiment.
- G. Robin's innovation: A constitution could *require* decisions to be based on betting market prices.
- H. Moderate example: A corporate charter could include a "fire the CEO" provision that says that if the value of the firms' stock conditional on firing the CEO ever exceeds its value conditional on retaining the CEO, the CEO gets fired.
- I. Robin advocates turning this approach into the basis for a whole system of government. He calls it "futarchy." Slogan: "Vote on values, but bet on beliefs." This means that:
1. The political process defines an objective function, such as "maximize GDP" or "maximize GDP plus the market value of leisure" or "maximize GDP per capita times life expectancy." As a short-hand, Robin calls the maximand GDP+.
 2. If betting markets say that a policy has a higher expected value of GDP+ than the status quo, the constitution *requires* the adoption of that policy.
- J. Ex: Someone proposes TARP. Betting markets on GDP+|TARP and GDP+|~TARP go online. If and when the value of the former exceeds the latter, TARP gets adopted. Critics can then set up betting markets about the expected effect of abolishing TARP.
- K. Most criticisms of futarchy argue that betting market odds are not to be trusted. These criticisms are weak, and often ignore extensive, specific counter-evidence and simple fixes.
1. Will the marginal suicide bomber change his mind if he add \$100 to his will?
- L. My main concern is with the definition of GDP+. A key weakness of central planning was that managers were given maximands that sounded good at the time, but gave perverse incentives.
- M. Thoughts?