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Economic Analysis of Separation of Powers

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of Separation of Powers**

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Economic Analysis of Separation of Powers

One of the most important institutional settings in each state is separation of powers. That setting defines the real area in which each of the groups of policy makers, politicians, bureaucrats etc. can act. Each of possible choices, which can be made, when designing such a system (e.g. while writing or amending a constitution or set of basic laws, which would play similar role), has substantial consequences. They can be economical, social, they can influence the incentives which are given to the politicians to free-ride on the society or their colleagues from the party, they can influence their public-interest orientation etc.

Analyzing such consequences is an important task, especially if one takes into consideration, that more and more developing countries plan to write for themselves and their societies new constitution. Also the on-going debate concerning the EU constitution can be another factor showing the accuracy of such a discussion. Therefore, it is crucial to analyze mentioned consequences. Considering the best methodology for such analysis, I chose to apply economic analysis to political institutions. In applying economic analysis I follow the approach described by Roger B. Myerson (2000). 'Economic analysis of political institutions' are defined as studying political institutions by the methods for analysis of competitive behavior that economists have developed. Which means, that they are not limited only to analysis of the effects that separation of powers and different institutional settings have on the market place. As can be derived from the introduction to that essay, I also decided to bound the scope of it only to analysis of separation of powers which are enclosed in the doctrine of constitutionalism. For the sake of simplicity, even if in some countries parts of the legal institutions described are not introduced within the constitution (e.g. electoral system, ways of choosing local representative etc.), I will not differentiate between them, as the main subject of that paper is separation of powers and its consequences.

Constitutionalism

Constitutionalism is the idea often associated with the political theories of John Locke and the "founders" of the American republic, that government can and should be legally limited in its powers, and that its authority depends on its observing these limitations¹. Reasons for such a self-limitation are various, with the personal liberty among the most important ones. According to classical approach, government should be limited by individual rights and system of checks and balances, codified in a formal constitution (Berggren & Karlson 2002).

Given that it is widely agreed that government and majority rule should be constrained, there is still an open question in what ways and to what extent they should be restricted.

In that paper I want to focus on the following institutions:

- Bicameral legislature,
- Electoral system and independently elected executive,
- Federalism,
- Independent judiciary and judicial review,
- Referenda,

In all of the examples, I will try to analyze what is the influence of each of the particular institutions on the political transaction costs, *external transaction costs* (I will be using also a term *external costs*) and on the quality of the decisions taken. Referring to the political transaction costs, I will benefit from the distinction proposed by Berggren & Karlson (2002) between the desirable and undesirable ability to act.

¹ Stanford Encyclopedia of Philosophy, <http://plato.stanford.edu/entries/constitutionalism/>

| | | |
|-----------------------|---------------------|------|
| | Ability to act ? | |
| Desirable to act ? | GOOD | BAD |
| | BAD | GOOD |

Table 1. Evaluation of when an ability to act is good and bad. After Berggren and Karlson 2002

Bicameral legislature

Bicameral system is a governmental system, where the legislature is divided into two chambers. They can have either equal power or one of them can be clearly superior to the other. In the western liberal democracies, having bicameral system, the second type of division is clearly more popular.

Bicameral legislature undoubtedly raises the political transaction costs, as for establishing new law there is a requirement of passing the decision through two deciding instances instead of one. In case of two chambers which have equal powers, and within which there exist two groups of politicians with different, often opposite ‘agendas’ (like one chamber which can represent constituent states and the other the national level) we can finish with a gridlock. Opposite ‘agendas’ of the politicians can result from their different perspective and their responsibility to the groups of two levels – one on the local and the other one national level.

From the other side, it can be logically assumed (and also shown on the empirical data from some countries like Poland), that the quality of the decisions increases. It is a consequence of few elements: firstly, the parties have to negotiate to reach an agreement, which increases the incentives to better motivate the decision, double-check its possible outcomes, motivates policy makers to collect more solid knowledge. Secondly, it decreases the possibility

of establishing by politicians the collusive agreement to tolerate each other's corrupt exploitation of the tax-paying public. In the system with only one instance there is much higher probability of a successful initiation of such an agreement and profit-taking behavior – two instances are controlling each other's behavior. There are many rational reasons for that, one of them can be the willingness to show yourself as the 'honest and trustful' one, with the opposition to the other chamber (as the 'bad guy'), and through that to gain more moral authority in the society.

Higher quality of the legislation leads obviously to lower external transaction costs. Avoidance of bad law, driven by populist motives, spares not only direct costs for the society, but also indirect ones – like unavoidable costs of future amendment of that law, which ones again will be associated with the risk of bargaining between politicians etc. Therefore, it can be concluded that even if bicameral system increases costs of passing a law, it increases only costs of passing a bad and uninvited law. Summarizing, bicameral system increases the political transaction costs in the cases when it is not desirable to act. It also increases the quality of the decisions taken, and altogether – it decreases the external transaction costs.

Electoral system and independently elected executive

When one considers the location of the executive powers, he can differentiate two systems: parliamentary and presidential one. From the other hand, the legislature can be chosen in a proportional representation system or in a majoritarian system, which results in different outcomes and different positions of the political parties in the system. Both of the factors should be considered and analyzed carefully, as the consequences that can occur from different choices are significant.

Firstly, I will analyze the way that the executive is elected. He can be chosen directly by the citizens – in a presidential system – or indirectly, by the legislature – in a parliamentary one.

The way that the executive is chosen, affects two major aspects of the use of power – it changes the perspective of the executive as well as his position in the system. If the executive is chosen independently, his perspective is more general. Firstly, he is the ‘real’ representative of the nation. He does not have to involve himself in the ‘power plays’ which characterize political parties. The legitimacy of his reign is the will of the nation, and not the distribution of votes in the parliament between different fractions. Therefore, his perspective is more public-interest driven than the one of those that have to take into account the interest of different parliamentary fractions. It is also much harder to change (before the end of his term) independently chosen president than the prime minister chosen by the parliament. Thus, president can think in the perspective of 4-5 years at least, while chiefs of governments chosen by political parties, must think in the perspective of the next party convention.

The second factor which influences the stability of the system, is the way the political parties are chosen. In the first system, the legislative seats are allocated in a proportional representation system, in the second one they are distributed according to a plurality voting rule. The proportional representation results usually with a multiparty parliamentary system, where the government is set up by more unstable and unpredictable coalition than in the plurality voting system (where the votes are usually split up between two parties). The former system, tends to create more political and external transaction costs – bargaining parties, to pass law favored by one of them, have to give some incentives for other parties to support it. In practice, there is often a trade-off: if you support us now, we will support you later. Therefore, the law and system can be incoherent, inconsistent and ineffective – so the quality of the decisions taken is also lower. From the other hand, two-parties system limits the choice of the voter. At the same time, the barriers to enter the ‘market’ (political scene) are so high, that it causes the costs similar to those which exist on the imperfect market – oligopoly results always with higher transaction costs. If one adds to that institutional setting another

dimension – presidential system, one must also conclude that it increases potential tensions and probability of the deadlock. However, presidential system is still better than the parliamentary one, and two-parties system is usually more efficient than the multiparty system, as it limits the space and scope of the bargaining and deal making between rent-seeking political actors.

Federalism

Federalism is a form of separation of powers, but the vertical not horizontal one. It is the theory or advocacy of federal political orders, where final authority is divided between sub-units and a center. Unlike a unitary state, sovereignty is constitutionally split between at least two territorial levels so that units at each level have final authority and can act independently of the others in some area². The consequences are as follows: center takes only decisions which are necessary to be taken at national level, and the rest of the power lays in the states, regions or other local bodies. Therefore, political transaction costs are much lower – policy makers are much closer to the local problems and have more knowledge and experience with dealing with them. The clear, vertical division of powers makes it easier to define the knowledge which the particular body should gather. Federalism enables the optimal design of the level on which decisions should be taken and also encourages people to participate in the deliberation on the shape of laws being passed. That not only decreases the political transaction cost, but also the external ones. At the end, if the decisions taken do not suit the inhabitants of the state, they can exit it and move to other one, better suiting their preferences. The obvious competition between states, so-called forum shopping, should lead (among other factors) to increase the quality of the law.

² Stanford Encyclopedia of Philosophy, <http://plato.stanford.edu/entries/federalism/>

Independent judiciary and judicial review

Independent judiciary and judicial review are two institutions which are the third pillar of the horizontal separation of powers. They assure that the laws passed are consistent, or at least not contradictory to the general principles which lay the basis of the state. There are also *ex ante* effects of the existence of independent judiciary and judicial review. Legislature and executive bodies, which are aware that their decisions may be reviewed by independent judicial bodies, have disincentives to pass bad policies. Therefore, those two institutions decrease the political and external transaction costs, and increase the quality of decisions taken – not only directly, by lifting the laws conflicting the constitution or general principles, but also indirectly, *ex ante*, by encouraging policy makers to implement good quality policies.

Referenda

According to main-stream literature referenda is the institution rather increasing the political and external costs. What I find strange is, that all types of referenda are considered to have the same influence of the transaction costs and quality of the decision taken. As far as I am concerned, I believe that it is wise to differentiate between referenda made on the national and local levels. In case of national referenda, it happens often that populist movements come into the voice and populist arguments are loudly articulated. That can not only increase transaction costs, but also significantly decrease the quality of the laws enacted. The discussion during referenda concentrates often not on the specific and particular issue, but on some broader rules and topics, including also some second-meaning issues like who the author of the proposal made is. Sometimes the public-interest oriented proposals are rejected by voters because of some short-term tensions between political actors. Therefore the debate often drives away from the core issue – if the proposal is of a good quality and if it is needed.

Contrary, when referendum is organized on the local level – more essential deliberation takes place. Firstly, people are better informed about the issue – as usually it is of lower generality and can have big influence on their day-to-day lives. Secondly, they are much closer to the proponents of the solutions or laws proposed and the debate is less political and less populist. The best example of successful implementation of the institution of referenda is Switzerland. In my opinion, locally organized referenda, can be perceived as part of the vertical separation of powers (in fact part of federalism) but should not be put in the same basket with national referenda. Former ones, can increase slightly political transaction costs, but can at the same time lead to the increase of the quality of the decisions taken. Contrary, the latter ones lead to the increase of political and external costs, often without increase of the quality of the decisions taken, or even with its decrease.

Conclusions

To summarize, it must be said that all of the institutions characterized above have often significant effects on the transaction costs – both political and external ones – and on the quality of the laws passed. However, it must be also recognized, that the influence that those institutions have is usually analyzed in *ceteris paribus* conditions. That is a very important factor, as the improper combination of two or more institutions (which by themselves bring the decrease in the transaction costs) can bring the increase of the transaction costs. It should be also underlined, that within the institutions there are internal differences, which consequent in different outcomes – parliamentary system can be also efficient (though not as much as the presidential one), but it is more probably in the case of two-parties system, than in the case of multiparty one. Referenda can be a well-performing institution, but only when it is set up on the local level, as a part of the vertical separation of powers. Referenda can also be a very good tool to improve the quality of the decisions taken (which makes it also a tool in a forum shopping practices and lowers the number of people choosing to exit the state). When

referendum becomes the national one, it can lead to the increase of the transaction costs and decrease of the quality of law, as it results in populist movements being sound wider and better. Therefore, decision-maker designing the separation of powers and different institutions in the system, or modifying existing ones, should be very careful with checking only for the separated results of each of the institutions. Even if observing or conceptually solving the problem of the synergy between institutions organized in different 'compositions' is hard task, I believe it is the one worth taking its time, as it can lead to success or failure of the economy, state, society. However, whatever the choice will be, clear and exact separation of powers leads to higher quality of the decisions taken, and therefore to the higher efficiency of whole system.

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