Thoughts on Deliberative Democracy Through the Lenses of the Economics Approach

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1. Introduction: Deliberative Democracy and Economic Analysis

The following notes attempt to provide several initial thoughts regarding a normative analysis of deliberative democracy from the perspective of the economics approach, broadly defined. Although the following analysis is conducted on a very general and abstract level, I believe that acknowledging the possible different philosophical frameworks and adopting the preferred one have immediate ramifications on different policy and micro questions relating to various aspects of election laws, as well as on other legal arrangements relevant to collective decision-making in modern democracies. In order to carry out such an exercise I will have to begin with a short working definition of “deliberative democracy” and of “the economic approach” (section 1), followed by a broad survey of the possible philosophical foundations of deliberative democracy, locating the economic approach within this grand map (section 2). Subsequently, I will address deliberation from the perspective of economics (section 3), which will serve the basis for revisiting the theory of the state a-la the science of economics (section 4). Section 5 will conclude. Most of the issues dealt with here are left open and this might frustrate the reader. I hope, though, that some of these issues, questions and considerations will prompt further research and will add a small brick to democratic theory in the 21st century.

1.1 Deliberative Democracy

Democracy is a system of collective decision-making, which relies on aggregation of votes (representing individual preferences) among all members of the political
entity (direct democracy) or among their representatives (representative democracy). A deliberative democracy requires that such a vote is conducted only subsequent to authentic deliberation (rather than merely the aggregation of preferences that occurs in voting).

This proposed tentative definition requires many clarifications as to its democratic component: in what precise way aggregation of individual preferences should be conducted in order to qualify as a democratic decision? For example, is majority vote a necessary and sufficient condition for a democracy? How should majority vote be conducted and what ought to be the collective decision in case of majority cycling (Arrow 1951)? As we will be focusing in this paper on the deliberative component of deliberative democracy we will set these questions aside, and focus on clarifications as to the component of “authentic deliberation”.

As opposed to the mere aggregation of pre-set preferences among decision-makers (all members of the entity or their representatives), deliberative democracy requires an exchange of views, the ability to present arguments and evidence in order to convince, and the construction of forums for such debates, probably under the assumption that individuals’ votes after deliberation might change in comparison to their original positions. As we shall see later, this is a crucial ingredient from the perspective of the economics approach. The more precise conditions for authentic deliberation are controversial. James Fishkin (2011), for example, specifies five characteristics essential for legitimate deliberation, which go beyond the process of exchange of views and arguments: (1) Information - accurate and relevant data is made available to all participants; (2) Substantive balance - different positions are compared based on their supporting evidence; (3) Diversity - all major positions relevant to the matter at hand and held by the public are considered; (4) Conscientiousness - participants sincerely weigh all arguments; and (5) Equal consideration - views are weighed based on evidence, not on who is advocating a particular view.

Different characteristics are specified by Joshua Cohen (1989). They include: (1) An ongoing independent association with expected continuation; (2) The citizens in the democracy structure their institutions such that deliberation is the deciding factor in
the creation of the institutions and the institutions allow deliberation to continue; (3) A commitment to the respect of a pluralism of values and aims within the polity; (4) The citizens consider deliberative procedure as the source of legitimacy, and prefer the causal history of legitimation for each law to be transparent and easily traceable to the deliberative process; and (5) Each member recognizes and respects other members' deliberative capacity.

From these two examples we can learn that the components of “authentic deliberation” which is the condition for a deliberative democracy, are varied and controversial. They relate to cultural, psychological, educational, and indeed institutional features. Constitutional and legal norms have an effect on all these features, but for some features the effect of laws is only marginal and indirect. We will focus on the features, mainly procedural and institutional, in which the law may make a direct and significant difference.

1.2 The Economic Approach

What is the “economic approach”? I argued in the past (Salzberger 2008) in the context of defining the “Law and Economics movement” that a better definition of the science of economics is neither through its subject matters (markets, prices, inflation, unemployment etc.), nor through its ideology (the normative goal of wealth maximization or efficiency), but rather through its methodology. According to this definition economics studies human behavior in a set situation by (1) transforming the complex reality to simplified reality, using simplifying assumptions; (2) operating rigorous (mathematical, graphical, experimental etc.) models on the simplified reality, examining the correlations and causal relationships between its different variables; (3) deriving conclusions as to the model’s variables and the causal connections between them; and (4) transforming these “laboratory” results into statements and policies concerning the real world.

Most works of economics scholars is on a positive level of analysis. Positive economics analysis seeks with the assistance of mathematical models and empirical tools to provide us with explanations of the causal connections between various variables, as well as predictions as to the effect of changes in one variable on others.
These relations are examined when other sets of variables are held fixed (or exogenous to the model). These theoretical causal connections can be tested empirically by means of another branch of economics, namely econometrics, and its major tool, multiple-regression, with the recent additions of experimental and behavioral tools.

Normative economic analysis is applied to rank alternative solutions, or to tell us what are the desirable legal or institutional arrangements. In other words, normative analysis tells us not what the policy or the legal rule is, or why it exists or what are its effects, but whether it is a good policy or rule and what is the desirable policy, decision or legal or constitutional arrangement or judicial outcome. This branch of analysis is significant because it can help us to evaluate various collective decision procedures and institutional set-ups. To perform a normative analysis one has to define a normative objective, the source of which is outside the scope of the science of economics. In this sense, and in the framework of the broad definition of “economics”, the normative goal can be considered as one of the simplifying assumptions within the economic methodology. The leading normative goal of most economic analysis literature is efficiency. However, several competing definitions of efficiency exist: maximization of total utility, maximization of wealth, Pareto optimality (which is comparable to consensual decision-making). Competing views also exist about the goal of efficiency: if it is the primary normative goal, as argued, for example by Richard Posner (1979) or a second-best to utility maximization, unattainable due to measurement problems, as held by 20th century Welfare Economics. In addition, efficiency is not necessarily an exclusive normative goal. Any teleological principle, including distributional objectives (as specified, for example in Rawls’ theory of justice), can be set as a normative goal of economic analysis. As we shall elaborate bellow, a major part of normative constitutional economics relates to a different normative goal (which coincides with one specific notion of efficiency) – consensus or Pareto optimality, which evolves out of different historical roots of the Social Contract theories of the state. In principle, non-teleological principles can also serve as normative goals for normative economic analysis.
2. The Philosophical Foundations of Deliberative Democracy

Deliberative democracy can be advocated, on the one hand, on behalf of deontological or non-instrumental moral theories; it can be advocated, on the other hand, on the bases of teleological or consequential or instrumental grounds.

2.1 Deontological Justifications of Deliberative Democracy

One can distinguish between two families of deontological theories in context of justifying deliberative democracy. One family is Natural Law theories which evaluate decisions or conduct on the bases of their compatibility with eternal and universal substantive good or rights and/or duties, regardless of their consequences in terms of individuals’ preferences or well-being (substantive deontology). It is not easy to justify democratic or majority decision-making on such deontological grounds, as opposed to other forms of decision-making, such as a decision by a moral expert who acts as a dictator, like the Pope. Whether a majority decision after deliberation is more likely to reach the policy or law or other decision compatible with Natural Law, more so than other forms of collective decision-making, is a complicated question, and since it is remote from the economics approach, I will not address it here. We can just note that the core criticism of such a deontological position relates to the question: how can we know what is the substantive good. If everyone is in an unanimous agreement about the nature of such good than decisions can be reached by consensus or by majority or indeed by a dictator (all yielding the same result); if, however, there is a disagreement regarding the substantive good, it is unclear which decision-making procedure, deliberative or otherwise, yields better chances to materialize the “right” outcome.

A second family of deontological justifications of deliberative democracy holds that the value of deliberative democracy is intrinsic and independent of its actual consequences in terms of individuals’ materialization of preferences or wellbeing (procedural deontology). Such justifications were argued on behalf of democracy in general, whereas the intrinsic values mentioned are self-government (e.g. Gould, 1988) and equality (e.g. Waldron, 1999; Singer 1973). Joshua Cohen, one of the
advocates of deliberative democracy can be viewed as holding such a deontological or intrinsic justification, adding to liberty (self-government) and equality, also the value of public justification.

According to his position (Cohen 1989), laws and policies are morally good to the extent that they are publicly justified to the citizens of the community, the direct essence of free and reasoned debate among equals. As articulated by Christiano (2008): “Citizens justify laws and policies to each other on the basis of mutually acceptable reasons. Democracy, properly understood, is the context in which individuals freely engage in a process of reasoned discussion and deliberation on an equal footing. The ideas of freedom and equality provide guidelines for structuring democratic institutions”. According to Cohen, deliberative democracy is freedom in two ways: (1) the participants consider themselves bound solely by the results and preconditions of the deliberation. They are free from any authority of prior norms or requirements; and (2) the participants suppose that they can act on the decision made; the deliberative process is a sufficient reason to comply with the decision reached. This statement clearly differentiates Cohen from Natural law theories, on the one hand, and from teleological theories, on the other, as his ideal democracy is judged neither by compatibility of its outcomes to morality, nor by the contribution of its outcomes to materializing individual preferences. The mere process of deliberative decision-making yields a just and desirable polity.

This position can be criticized on various grounds. Let me mention here two points, which are especially relevant in context of utilizing the economics approach: (1) It fails to provide us with an external criteria to compare different systems of deliberation, or to fine-tune the exact best procedural and institutional set-up. When there is no clear measurable goal against which one can evaluate the rules, institutions and actual practices of deliberation, at least from the perspective of economic analysis we are at a cul-de-sac; (2) This justification also fails to connect the deliberative process and the final decision-making rule that has to be applied to reach a conclusive decision, whereas implicitly simple majority is still viewed as the desirable decision-making rule. It is not easy to justify simple majority on deontological bases (or, indeed, as elaborated bellow, on teleological bases) and it is unclear to me how this can be remedied when authentic deliberation preceded a vote,
when after such deliberation there are still members who oppose the suggested decision. Deliberation will not necessarily remedy a decision violating basic rights of those who oppose it and in this context such a decision will promote neither an external good (i.e. a Natural Law type of morality), not a consequential goal such as utility, efficiency or distributive justice.

A possible different interpretation of this view is that deliberation is desirable because it promotes consensus. It seems that many advocates of deliberative democracy, including Cohen himself, make a connection between deliberation and consensus building. Adopting this interpretation, however, shifts the type of justification for deliberative democracy from non-instrumental/deontological one to an instrumental/consequential one. I will return to consensus shortly, but let us first provide an overview of possible instrumental or teleological justifications for deliberative democracy.

2.2 Teleological justifications for deliberative democracy

We can distinguish again between two families of teleological or instrumental justifications for deliberative democracy. One family that can be dubbed “simple instrumentalism” argues that deliberative democracy is justified because it yields good laws and policies. Theses laws and policies are better than those of other types of regimes because the interests, rights and opinions of most people in society are taken into account. In fact, John Stuart Mill (1861) made such an argument on behalf of democracy in general, which forces decision-makers to take on board the interests of many, as opposed to a monarchy or aristocracy. This is the result of the fact that democracy gives some political power to each. Such a line of reasoning can be extended or perhaps fortified to argue that deliberative democracy takes into account even more interests of more people than a democracy without deliberation. Deliberation enhances the collective information regarding the interests, preferences and material facts relevant to the decision, and thus is likely to improve the decision. In a deliberative democracy people are more informed, they think carefully and rationally more than in other regimes (including mechanical democracy) because they know that they can make a difference, not only regarding the final outcome, but also with regards to their fellows’ preferences.
Possible criticism against this line of reasoning is similar to the one we spelled out against the second family of deontological theories. Simple instrumentalism fails to enable comparing competing deliberative institutions and rules, as the different policies and decisions resulting from the competing deliberative democracy cannot be compared.

The other family of teleological justifications for deliberative democracy can be dubbed “complex instrumentalism”. This family should be the focal source for the economics approach. It goes one step further from “simple instrumentalism” and evaluates the type of regime or the collective decision-making process according to its effects on the wellbeing of all individuals or on materialization of their preferences. Such justifications originate from the moral theory of Utilitarianism, on the one hand, and from the Social Contract political theories, on the other. Liberalism is the starting point for both. Three of its significant foundations are: (1) That there is no value save individuals’ values, or, in other words, collective good or morality is judged according to some kind of aggregation of the utilities or wellbeing of all individuals in the polity; there is no added value originating from any collectivity; (2) Every individual’s preferences or wellbeing has to be equally considered when collective decisions are made; and (3) Individuals are rational in the sense that they know what is good for them and they will engage in the collective decision-making process to promote their good accordingly. The first foundation implicitly rejects a Natural Law type of morality according to which there is universal, eternal and pre-given distinction between good and bad, moral and immoral. On the contrary, good and bad are subjective; what is good for one person might be bad (or immoral) for another. A collective moral decision is thus an aggregation of individual preferences, which according to the second foundation, has to give equal weight to each individual; every preference has to be incorporated in the collective decision-making process on the basis of the equality principle. Utilitarianism and its derivatives (among which wealth maximization - the prime normative goal of the actual writings associated with the economics approach) deduct from these foundations that the moral collective decision-making is the one that maximizes society’s total utility, i.e. the sum of all individuals’ utilities. A good
policy or collective decision-making procedure is the one that enhances total utility, and the best decision is the one maximizing total utility.

An alternative deduction within “complex instrumentalism” can be attributed to some of the social contract theories. According to a simplified articulation of these theories, only collective decisions that gain a consensual support (directly or indirectly as elaborated bellow) are desirable or morally correct. A straightforward justification for this principle implicitly presupposes the foundations of Liberalism: if there is no collective value save individuals’ values and individuals are assumed to be rational, knowing what is good for them, a decision agreed upon by everyone is by definition a good one. A different justification views consensus as a second best to utility maximization, which cannot be practically materialized; this is due to the fact that utilities cannot be measured and are not comparable across individuals. Since individuals are rational, decision reached by consensus, by definition, increases the wellbeing of every person participating in the vote and hence increases aggregate utility. Moreover, a decision which maximizes society’s utility can be reached through consensus, because if it really enhances total wellbeing those who gain from it will be able to compensate those who loose from it until the latter will be indifferent (and thus will abstain), or will be slightly better-off (and thus will support the decision), achieving a consensus.

Having said this, consensual decision-making is hampered by decision-making costs and strategic behavior. The latter is the result of the very same factors that brings us to the second best in the first place - that individual utilities resulting from acceptance or rejection of a policy or law are not in the public knowledge. We, therefore, cannot rely on conducting consensual decision-making for every collective decision. We rather construct in the consensual social contract (or in legal terminology – the constitution) the fundamental rules of the polity, which are characterized by a their general nature, diminishing the likelihood of strategic behavior (an idea equivalent to Rawls’ veil of ignorance). The constitution also delegates by consensus the day-to-day collective decision-making to representatives, using majority rule, and balance this delegation, on the one hand, by introducing veto type mechanisms such as substantive bill of rights and judicial review, and, on the other hand, by structural-institutional elements, such as separation of powers,
meant to shift the decision-making rule from simple to super majority. These balancing elements reflect the fact that majority decision-making alone will not materialize the best decisions a-la complex instrumentalism. Simple majority decision-making does not reflect any intensity of preferences and thus will not likely to yield utility-maximization or consensus (and of course will not reflect any external morality such as Natural Law one).

How can deliberation affect the analysis of “complex instrumentalism”? This is the key question when deliberative democracy is analyzed within the framework of the economics approach. The standard microeconomics market theory, as well as the economic analysis of the state and its institutions, assumes that individual preferences are fixed. The market mechanism or collective decision-making process is meant to yield the best results in terms of aggregating pre-set preferences. Deliberation, under this assumption, will not be able to improve the collective outcome and since it comes with a cost (the actual decision-making process cost), it would be viewed as inferior to mere voting procedure. If, however, we change the assumption and alternatively assume, either (1) that individual preferences may change as the result of the market mechanisms and indeed as the result of the collective decision-making processes, or (2) that as a result of deliberation some individuals will cast their vote against their preferences, acknowledging that preferences of others are much more important in a specific question than their own (one person prefers A to B but only slightly, and once she knows that another person prefers B to A because A will yield a catastrophic result for her, the first person will vote for B despite her small preference for A), then we are on a very different analytical territory. In such a territory deliberation might improve the decisions vis-à-vis the goals of complex instrumentalism, i.e. achieve higher levels of aggregate utility or satisfaction of preferences, or promote the chances to achieve a consensual decision.

An interesting possible illustration of incorporating deliberation into the contractual justification of collective decision-making is Jean Jacques Rousseau’s concept of the “General will” (Rousseau 1762). The political theory of Rousseau certainly belongs to the social contract tradition. However, one can classify it outside the scope of Liberalism and as part of the Communitarian tradition which ascribes value in
society beyond the values reflected by the preferences of its individuals, thus violating Liberalism’s first foundation. The “general will” (or the general good) is portrayed by Rousseau as distinct or separate from some kind of aggregation of all individuals’ wills. This begs the question as to the source of the difference between individual preferences’ aggregation and the “general will”. Bypassing Rousseau’s own somewhat vague explanations regarding this gap, we can attempt to attribute, within a Liberal terminology, the difference to a change of individuals’ preferences (or their final vote which goes against their preferences), which is the result of the political or decision-making process itself. In other words, while the classical Liberal political theory (originating from Hobbes 1651 and Locke 1690) implicitly assume that individual preferences are fixed and that the political process is a mere exercise of preferences aggregation, Rousseau’s theory can be interpreted as an early version of deliberative democracy, assuming that individuals’ preferences (or final vote) are not exogenous, but endogenous to the political process. Accordingly, the difference between the general will and the sum of the wills of all individuals can be presented as the result of changes of preferences (or vote casting), from self-regarding towards more cooperative, other-regarding and less-conflicting preferences. This change of preferences or vote is the result of collective endeavors, such as deliberation and participation. This is the key element in the economic approach towards deliberative democracy, which will be addressed in the next section.

3. Deliberation: an Economic analysis

The branch of economics that examines collective decision-making as an aggregation of individual preferences or opinions in small groups is Social Choice (a sub-branch of Public Choice, which deals also with the effects of large groups decision-making procedures, such as interest groups effects and rent seeking). Social choice analyzes the interaction between: (1) a group of possible decisions, (2) a group of decision-makers, and (3) decision-making rule and procedure. The analysis can be conducted on the positive level (given set group of options, group of decision-makers and decision-making rule – what are the likely outcomes in terms of materializing preferences or of the quality of decisions) and on the normative level (for a certain type of decision – what are the optimal decision makers group
One can distinguish theoretically between two types of collective decision-making: aggregation of preferences (in the narrow sense, i.e. where no external truth exists) and aggregation of knowledge. The latter type of decision-making is characterized by an existence of external truth and the focus of the analysis is on the procedure (or decision-making rule and decision-makers group) that will yield the highest chances for the collective group to get to the truth (or on the positive level of analysis – given a group and a rule, what should we expect the decision to be in terms of proximity to the “truth”). Under this framework, for example, if we assume that each decision maker has the same probability, higher than 0.5 (i.e. higher than flipping a coin), to reach the “correct decision”, a majority rule is the best decision-making rule for deciding between a finite set of options (such as guilty or innocent in a trial or among three policy options for a legislature) and the probability to reach the correct decision is higher, the higher is the number of decision-makers taking part in the vote (The basic maxim can be attributed to the Jury theorem of Condorcet, revealed and expanded by Black (1958); a more general theorem is offered by Ben Yashar and Paroush (2001)).

For a dichotomous set of options (such as sentencing - number of years in prison – or amount of damages, or amount of budget allocation for a certain item) the average (rather than the majority) is the best decision-making rule and again the probability to reach the right decision rises with the number of decision-makers (Hogarth 1978; Budesco et. Al 2003). For both types of decisions (set number of options and dichotomous) a relatively small group of decision-makers is sufficient to significantly increase the chances to reach the correct decision in comparison to a sole decision-maker. Beyond three decision-makers the marginal benefit of additional member is small and might be outweighed by the emerging cost of the decision-making process itself (a factor that can generally justifies, for example, a three judges’ bench).

When aggregation of preferences is carried out the assumption is that there is no objective external “correct” decision. Economists were focusing on positive analysis of such an exercise and perhaps the most notable contribution in this direction is
Arrow’s impossibility theorem, which generalized the paradox of the rational individuals and irrational society articulated by Condorcet in context of majority decision-making. Condorcet showed that even for a small number of 3 decision-makers and 3 optional decisions, even when each individual has a complete and transitive order of preferences for the three options, majority decision-making may result in a cycle where A is preferred to B, B is preferred to C and C is preferred to A). Black (1958) and Sen (1971) elaborated on the conditions in which this paradox is avoided, primarily when all preferences profiles are single picked. Arrow (1951) generalized and proved that there is no decision-making rule that meets five basic conditions, among which is the Pareto condition – if all voters prefer one option to another, this option ought to be ranked higher than the other option as the result of the collective decision-making procedure. In simple words, Arrow proved that the paradox of rational individuals and irrational society is not limited to majority decision-making. On a normative level, if the Pareto condition is viewed as the normatively pivotal condition (reflecting consensual decision-making or the founding rationale for the social contract political theories) we can examine which decision-making procedures materialize it, the obvious one is unanimity or consensus.

So far I mentioned the two analytical frameworks for collective decision-making – aggregation of preferences and (the usually forgotten framework of) aggregation of expertise. In the real world, however, many decisions are a combination of the two types and/or there is a disagreement as to the exact nature of the decision, which is the result of different meta-philosophical positions. For example, for Natural Law type of deontological theories there is an external “correct” decision for all types of decisions, including those that for Utilitarians or Positivists are mere preferences aggregation. Similarly, whether a decision regarding the guilt of an accused in a criminal trial is a matter of preferences or knowledge depends on a philosophical position regarding the existence of objective truth. This factor naturally complicates the analysis in a field that has much more potential for further development. Since our particular focus is on deliberation we will leave these serious questions aside and focus on the affects of deliberation on these analytical frameworks and their results.
Under the expertise framework, the focal question is whether as a result of deliberation better experts can convince their fellow decision-makers in the correctness of their positions, increasing the probabilities for the collective body to reach the right decision; or whether the joint interactive efforts of a group of people who might combine different pieces of information and know-how or skills, each held by a different individual decision-maker, would increase the probability to reach the right decision in comparison to a mere vote without deliberation. Social psychology has addressed such questions not exactly in the framework articulated here, but in a way that can provide us some leads for further research. Psychologists differentiate between a nominal group and an interactive group. This dichotomy roughly corresponds to aggregation of votes without deliberation (nominal group) as opposed to aggregation of votes with deliberation (interactive group).

Various experiments found that, side-by-side to the improved performance of the interactive group in comparison to a nominal one, achieved by combining information and know-how, there are several social effects that actually harm the working of the interactive group and thus decrease the probability to reach the correct decision. Such effects include: conformism (e.g. Asch 1955), informational cascade and reputational cascade (e.g. Sunstein and Hastie 2008), group polarization (e.g. Sunstein 2007) and the common knowledge bias (e.g. Wittenbaum et al. 2004). The numerous experimental studies conducted in the past decades do not amount to a clear-cut conclusion as to a categorical advantage of interactive groups over nominal ones. Further research has to be conducted on the categories in which deliberation improve performance and the type of tasks in which deliberation diminish the level of performance. Such findings should have significant implications on the value of deliberation outweighed by its costs and may provide possible refinement and detailing of the specific policies to promote constructive deliberation and avoid wasteful deliberation. In addition, the vast majority of experiments were conducted in lab conditions. Their application to real world decision-making may not be straightforward. For example, as argued by some deliberative democracy adherers, the advanced knowledge about the exact process of decision-making might have an a-priori effect on the level of knowledge and preparation of the participating decision-makers. Similarly, the real world implications of crucial decision-making might lead to different conduct than in game
type lab experiments. Other bodies of knowledge and additional branches of behavioral sciences have to be incorporated into studying these questions and at this stage we can only raise the questions and possible frameworks to address them, without providing definite answers that can assist us to prescribe the exact optimal laws and procedures.

Things might be different when deliberation in the framework of preferences aggregation is analyzed. Under the Liberal (value in society is comprised solely of individuals’ value) and consequential (the desirable decision is the decision which ‘best’ materializes individuals’ preferences) normative framework, we cannot measure the performance of a group against an external “correct decision”. As elaborated above, traditional economic analysis assumes, on the one hand, fixed and exogenous preferences, and, on the other hand, rational behavior according to which individuals will cast their vote according to their preferences. Under such assumptions, by definition, there is no benefit in deliberation and the only question is the decision-making rule that will best maximize the preferences of all group members. Deliberation may matter if we relax these rigid assumptions in one of the following ways: (1) individual preferences are not fixed and are not exogenous to the decision-making process, and/or (2) individuals may cast their vote against their preferences if they are convinced that supporting an opposing opinion is very significant to others and might not be very significant to them (as the result of the intensity of preferences, which is not accounted for when a regular vote of yes or no is conducted). Under these new terms we are in a totally different ballgame.

The debate among the US founding fathers can be explained in the framework we just articulated. The Federalists implicitly assumed fixed preferences and their advocacy on behalf of a big polity was the result of (in modern terminology) interest groups and rent seeking analysis. The anti-Federalists who opposed a big political entity can be presented as implicitly assuming that only in a small polity where people know each other, care about each other, understand their fellow citizens stances, there is a likelihood that preferences will transform from pure egoistic preferences towards more other-regarding preferences, and/or that people will cast their votes against their selfish interest when they acknowledge that interests of others are of greater weight or intensity. It seems that the debate is still undecided,
and perhaps the format in which it is phrased here can prompt more sophisticated studies, both empirical and experimental, which will enhance our understanding. A tentative conclusion, however, is that vis-à-vis the economic approach deliberation before voting can improve the quality of the decisions in some cases but not in all.

The last section of this paper revisits the traditional economic theory of the state, adding the ingredient of deliberation to each of the links comprising the skeleton argument.

4. The Economic Theory of the State and Deliberative Democracy

Ever since the Eighteenth-century works of Borda (1781) and Condorcet ([1785] 1955) on majority decision making, the economic approach can be viewed as having a stake in analyzing the ‘state’, its organs and its procedures conducting and coordinating the activity in the public sphere. Public choice is the major branch of economics that focuses on these issues, as it is interested in economic analysis of non-market decision making, or in individual decision makers as participants in complex interactions that generate collective decision making and political outcomes (Mercuro and Medema 1997, p. 84). Questions related to the theory of the state are also dealt with in the framework of game theory (Baird et al. 1994). Indeed, Hobbes’s Leviathan ([1651] 1979) can be regarded as the first game theory explanation for the creation of modern states. Likewise, the main stream of Neoclassical economics on its various sub-branches, including the traditional micro-economic paradigm, on both normative and positive levels of analysis, is also employed as a methodological tool to discuss various questions related to the theory of the state.

The microeconomic analysis of the emergence of the state focuses on possible market failures, which justify central intervention in the market. Such central intervention requires the existence of a state and central government. More particularly, the market failure of public goods is often portrayed as the main rationale for the very establishment of the state (Buchanan 1975, pp. 35–52–on the normative level of analysis; North 1981–on the positive level). One of the major goals of such a creation is to enable economic markets to operate, thus establishing
private property rights and ensuring that they will not change hands involuntarily by bypassing the market. The ability to operate markets is itself a public good which needs a central pre-market intervention in the shape of a political entity such as the state. The creation of property rights is also one of the focal points of the contractarian view of the state (Skogh and Stuart 1982).

In recent decades Neo-institutional economics is engaged in projects in which the traditional market analysis – microeconomic or welfare economics – is incorporated into the public choice paradigm. The new theoretical and methodological frameworks brought about an increasing interest of the economic approach in the analysis of the public sphere, as can be exemplified by recent writings on constitutional law and economics (e.g. Mueller 1996; Cooter 1999; Voigt 1999 and 2012 for an updated literature survey). On a positive level of analysis, the various economic methodologies aim to explain why institutions are structured the way they are and how these structures affect the outcomes of social or collective choices. On a normative level of analysis, different theories offer ideal models for the structure of government, the division between constitutional and post-constitutional arrangements, the desirable form of separation of powers and related questions. Some of the differences between the normative models are the result of different starting points with regard to the leading moral principles, which ought to guide collective action. Thus, most Neoclassical or Chicago school economic writings aim at wealth maximization as the ultimate normative goal, while most public choice literature is constructed upon the social contract tradition, or its economic equivalent – the Pareto principle. This latter guiding normative principle will be the paradigm adopted here for the following skeleton argument or for the various links in a chain construction of a theory of the state, in the framework of which we will examine the added value of deliberation.

4.1 The Foundation of the State

The common theme of most theories that discuss the creation of the state (save those Natural Law theories which view the state as a “natural creation”) is that the establishment of the collective entity called ‘state’ is desirable because it can benefit the individuals who are to become its future citizens. The meaning of ‘benefit’ is, of
course, contingent upon the substantive–normative foundations adopted by each theory. But these foundations are not limited to a consequential (teleological) or procedural sort of morality, such as utilitarianism, wealth maximization or consensus. They are broader than the common foundations of the economic approach. This idea, of transformation from a state of anarchy to a centrally governed society, was put forward by Thomas Hobbes in *Leviathan* ([1651] 1979). Indeed, Hobbes can be viewed as both the founder of the social contract tradition and the founder of the economic theory of the state. His ideas were rephrased in economic language in the second half of the twentieth century, by, among others, Downs (1957), Buchanan and Tullock (1962), Buchanan (1975), North (1986) and Mueller (1996).

There are different contemporary variations of this idea. Some theorists emphasize that the establishment of the state, or any political society, is a response to the market failure of public goods. Those goods will not be produced (or will be under-produced) in the absence of a central collective organization. Thus, the state is created, according to this rationale, because it enables the production and consumption of public goods, which are not produced or supplied in the state of nature (Buchanan 1975, pp. 35–52). Security and justice are two of the most notable examples of such goods (the former is the sole justification for the establishment of the state according to Hobbes). The mere ability to operate markets based on private property and voluntary transactions is another such good (John Locke justified the state as a collective mechanism to protect private property). Other theorists view the emergence of the state in a way similar to Coase’s (1937) description of the emergence of the firm – a result of vertical integration. This is caused by high transaction and information costs associated with contracting within markets, which force production and exchange out of the markets and into hierarchical organizations such as the firm or the state (Silver 1977; Macey 1989). A related view portrays the state as a framework for providing alternative institutional arrangements to contracts in the free market, which cannot be negotiated due to high transaction costs (Tullock 1982). In a different place I argued that the emerging information technologies of the late 20th century have significant effects on transaction cost in this realm (Elikin-Koren and Salzberger 2004, Ch. 10) and thus ought to bring us to revisit the rationales for the traditional territorial collective entity. But since this point vis-à-vis
the mere justification for the establishment of the state is not connected primarily to deliberation, we will not pursue it here.

Following the consensus leading normative principle, the establishment of the state is justified by the economic approach if it is the result of a contract, to which all individuals who are the states’ future citizens are parties. In political or legal terms, this contract is dubbed ‘constitution’. This consensual agreement is portrayed by some scholars (e.g., Rawls 1971; Posner 1979) as a hypothetical consent, and indeed, it is not easy to find historical examples for full consensus as to the content and wording of the constitution. However, in many cases the drafters of constitutions who set the terms for their ratification make a serious attempt to obtain very wide support for the document as a condition for its adoption. This can characterize the process in which the United States Constitution was crafted, as well as the more recent processes of adopting new constitutions in the countries of East and Central Europe, which have undergone a transition from communism to democracy (Salzberger and Voigt 2002). In the majority of these countries the constitution was the result of an agreement in roundtable talks including representatives of all political groups followed by a referendum.

The consensual mode for adopting a constitution implies that many constitutional documents reflect numerous compromises and additions of various articles in order to obtain general consent. Deliberation is naturally the main mechanism to compromise different preferences in order to achieve wide agreement. However, it does not require special norms, institutions or procedures, in contrast to majority decision-making processes in the post-constitutional change. This is due to the general nature of constitutional articles, which usually cannot be perceived as working for the benefit of certain groups and against the long-term interests of other groups, primarily because in such a constitutional formation stage groups are in uncertainty with regard to their future political powers, creating a de facto veil of ignorance. In addition, the reliance on unanimity implies that unlike majority decision-making, which is bound to result with actual decision, lack of constitutional compromise will result with no constitution. If Hobbes assertion that the state of nature is worse than any kind of polity, the decision-making rule of consensus will generate deliberation even with no formal procedures or institutions.
However, conventional constitutional making has been perceived as possible only through the work of agents or representatives – members of constitutional assemblies – rather than a product of the general consent of all future citizens of the emerging entity (although in many cases the constitution-making process is conditional upon approval by a general referendum). The reason for the need of agents is high decision-making costs. It is this representative element that begs a more serious look at the possible effects of deliberation forums on constitutional making. In addition, current technology may significantly decrease transaction cost of consensus building among all people, a factor that should have an effect on constitutional crafting in the future. New information technologies enable not merely cheap and widespread communication of individual preferences, but the employment of software that can aggregate preferences, negotiate bargains across various issues and identify resolutions and packages that enjoy consensual support (Salzberger and Elkin-Koren 2005). Whether virtual deliberation is likely to yield better results than physical deliberation is another question waiting more thorough empirical test.

4.2 The rise of central government

In line with the normative foundations of the economics approach specified in section 2, the contract, or the constitution, should lay down the basic principles guiding the post-constitutional interactions of individuals – the protective role of the state – and the basic principles dealing with collective action, its productive role (Buchanan 1975, pp. 68–69). In its protective role the state serves merely as an enforcement mechanism of the various clauses in the social contract, making no ‘choices’ in the strict meaning of the term. In its productive role the state serves as an agency through which individuals produce and allocate public goods (Gwartney and Wagner 1988). Carrying on both functions requires institutions: a constitutional court for the protective function; a legislature and an executive for the productive function.

The argument of the economic theory of the state justifying the establishment of central government goes like this: the initial contract, obviously, cannot foresee
every potential problem in both domains – the protective and productive roles of the state, especially where the constitution is designed to be in force for a very long term. According to the unanimity rationale, the solution for a new public issue popping up on the agenda would have been to gather everyone and decide upon it unanimously. But such a solution would involve immense decision-making costs. This is the major justification, given by most scholars, for the need to have a central government in which the powers to protect and produce are deposited, or, rather, entrusted.

The economic reasoning for the resort from consensus to majority rule is best represented by the model of collective decision-making set by Buchanan and Tullock's *Calculus of Consent* (1962). This model can be considered as one of the classical presentations of a normative analysis of collective decision-making in the framework of the consensus principle. Buchanan and Tullock distinguish between external costs of collective decision-making and internal costs. The former is the total costs to individuals negatively affected by the collective decision. These costs diminish, as the majority that is required for reaching a decision is larger. In unanimous decision-making the external costs are reduced to zero, as rational individuals will not grant their consent to decisions that harm them. A dictator's rule inflicts the highest external costs on the members of his or her community. The internal cost function reflects the costs involved in the decision-making process itself. It is shaped in an opposite way to the external cost function: dictatorial rule is the least expensive to operate. As the majority required for passing a decision is greater, so are the costs involved in the decision-making process. Consensual rule is the most expensive to operate. The optimal decision-making rule, according to Buchanan and Tullock, is the one, which minimizes the sum of the two types of costs. Buchanan and Tullock show that in most areas this optimal rule is a simple majority, but there might be special types of decisions (e.g. decisions which touch upon basic human rights) in which the optimal decision-making rule is a qualified majority. The Buchanan-Tullock model is one of the few modern justifications for majority rule.

The application of this framework in the current information technology era is interesting. While the external cost function is not affected significantly in comparison to the one of the non-virtual world (subject to the assumption that individual
preferences are exogenous to the political process), the internal cost function - the decision-making costs - will decrease significantly. Collective decisions are cheaper to arrive at because of lower information costs, negotiation costs, and communication costs. If the marginal cost function of decision-making as related to the majority required for deciding is more moderately sloped, we can expect the optimal decision-making rule to be greater than a simple majority. Hence, the democratization in the Internet is reflected not only by weakening the dependency on representative structure and the agency costs it is associated with, but also by shifting the decision-making rule from simple majority towards super-majority, all this in the framework of consensus as the leading normative principle for collective action. This can increase the total well being of the members of the community.

In contractual terminology, the establishment of central government and other state institutions is the result of uncertainties that exist in each individual’s mind about the future of the society in which one lives and about the future behavior of other members of that society (Mueller 1996, p. 61). The two solutions offered by modern democratic theory to the immense costs of maintaining unanimous decision-making in the public sphere are representative democracy and majority decision-making. Indeed, the Athenians’ resort to majority rule and to the appointment of government personnel by lottery was intended to overcome the difficulties of consensual decision making (although the latter remained the ultimate goal); so does the modern developments of representative democracy and the tools, such as the separation of powers, designed to overcome its fallacies. One can describe the post-constitutional government as a compromise that includes, on the one hand, delegation to representatives and resorting to majority decision-making, and on the other hand, structural constraints, such as separation of powers, and substantive constraints, such as an enforceable bill of rights, which balance the shift from unanimity to majority and from direct to representative government.

On a positive level of analysis, the mere apparatus created to balance the shift to majority decision-making by representatives, promotes deliberation. A law requiring approval of two houses of parliament and a Presidential consent will slow down the legislative process and generate deliberation to secure the support needed for its successful approval, in comparison, for example, to unicameral parliamentary
democracy in which a law is legislated by one organ. Similarly, voting procedures, such as three readings create similar deliberative effects. However, as we currently witness the contemporary US deadlocked politics, this sort of deliberation is not sufficient to yield satisfactory results vis-a-vis the normative foundations of consensual decision-making. I think that this is one of the key questions for deliberative democracy advocates. It can be argued, for example, that parliamentary democracy with proportional representation better facilitates constructive deliberation, which is the result of the fact that more voices, groups and ideologies are represented in parliament, and indeed in coalition governments. Let us examine, therefore, in more details, what can deliberation achieve in the general framework of the economic approach and what are the possible structures and institutions that could materialize such achievements.

4.3 Representative government

Representatives acting on behalf of their constituents save the costs of frequently measuring public preferences on each and every issue and the prohibitively high costs of coordinating massive numbers of people. In addition, many collective decisions involve at least some components of expertise decision-making in contrast to mere aggregation of preferences. Representatives who are fully engaged in crafting public policies accumulate such expertise skills, information and know-how. This means that the outcome of a small group of decision-makers from this expertise perspective might be more qualitative than a decision of the masses. Thus, despite the significant cost reduction of communicating and processing individuals’ preferences, which is the result of the rapidly advancing information technologies, the role of representatives should not be deemed totally obsolete.

Technology today creates new possibilities to efficiently collect information from individuals by asking them to click their preferences directly onto the screen. It reduces transaction costs involved in collecting information about preferences. Cyberspace also facilitates fast and cost-effective information processing that allows real-time feedback on public preferences and choices. This, in turn, lessens the need for some agencies and for their scope of functions. The reduced costs of coordination and communication diminish the extent of collective action problems,
such as interest group bias. If transaction costs involved in coordination are low or non-existent, there is a lessor need for representatives – intermediaries – to reflect the aggregated will of their constituents. Individuals may directly communicate their preferences on each and every matter.

In addition, low transaction costs may allow individuals, who cannot do it in the non-virtual world, to become organized. Cyberspace reduces the cost of identifying relevant parties, communicating, acting together, and spreading information that concerns all. In the old world it was much easier for a small group of interested individual to get organized. Their cost of organization was lower than the rents they could seek from such an organization, while for larger groups (e.g. consumers) the cost of organization have been much higher than the rents this collective organization could have extracted (Olson 1965). This can (and should) lead to increased democratization and decentralization of rule-making processes, allowing citizens to take a more active part in governance, and to effectively monitor government actions.

Parliaments in many countries are currently engaged in various projects to delegate more decision-making powers to the public in large or to incorporate the general public in the social decision-making process. However, from theoretical and normative perspective of Liberalism it is the public in large that delegates powers to representatives, and the rationales for such delegation, such as the immense decision-making costs of the public in large, are seriously impaired by the technology provided by the Internet. In other words, when legislators and other politicians talk today about more participation of the general public in their work, they talk within the current democratic paradigm, in which representative government and majority decision-making are taken as given truths. What is hinted here is that the revolution of the information technology ought to provide us with incentives to rethink the existing paradigm, to rethink whether representative government and indeed central government is needed at all, and if so, whether it ought to be guided by majority decision-making.

The above analysis raises questions about deliberation which are different from the questions addressed so far. One of the pivotal questions is whether the benefits of
deliberation in the physical world vis-à-vis increasing the probability to reach the right decision (from both perspectives of preferences aggregation and expertise aggregation), is comparable to the effects of virtual or on-line deliberation. Sunstein (2001) argued that the architecture of the Internet may encourage people to close themselves in homogeneous communities or enclaves, immune from diverse views, and thus in danger of creating Cyber-cascades. This, according to Sunstein, will diminish shared national experiences and the real deliberative nature of democracy would be lost. In economic terms, Sunstein argues that the internet may make people more egocentric in their preferences and less other-regarding. Thus, from the point of view of collective decision-making the outcomes will be worse.

However, these claims are yet to be empirically tested and an opposing argument can be made, according to which interactions in the internet in fact bring individuals to be more exposed to differing views than for those who are not part of the non-virtual world. To complicate the picture, the way that the internet is structured and regulated have an immense effect on the truthfulness of the opposing hypotheses. For a deliberative democracy advocate, therefore, the new field of regulating the internet by legal norms, as well as by technical architecture, becomes a focal point, and we yet have to wait for empirical findings whether deliberation on-line creates cascades and thus is inferior to non-virtual deliberation or vica versa.

The latter points are highly significant from a Republican point of view. Some Republican theorists of the state, in contrast to pure Liberal theorists, emphasize that central government is not needed only to reflect the preferences of the wide public in a more efficient or cheaper way, but that central government ought to lead the general public towards civic virtues and “better” preferences. This idea was phrased sharply by Edmund Burke in his famous Address to the Electors of Bristol (1774). He said: “Your representative owes you, not his industry only, but his judgment; and he betrays, instead of serving you, if he sacrifices it to your opinion”.

Other Republican theorists emphasize the need of the desirable political community to have not only technical mechanisms of preferences aggregation through representatives, but a more substantive content to the public sphere which will enable real deliberation and participation. Such forums are likely to shift self-
centered individual preferences into more public-regarding preferences. This Republican idea is reflected by Rousseau’s distinction between the general will and the sum of individual wills or preferences. For a deliberative democracy advocate it is crucial to analyze the differences between the two Republican ideas. The type of ideal deliberation might be very different when it is meant to bring individuals to be more informed and to bring their preferences to be more other-regarding, as opposed to the view of government as a trustee which does not have to reflect peoples preference ex-ante but to get their approval and support ex-post.

4.4 The Organization of Government - Separation of Powers

We talked about the justifications for the state and its central government. The next link in a skeleton argument for the economic theory of the state is connected to the structure of central government. This desirable structure ought to be derived from the list of functions assigned to the state. The list of these functions is embodied in the rationale for central government itself. Here I want to relate to their specification and organization. The doctrine of separation of powers is the major structural principle of the economic theory of government. Separation of powers can be viewed as comprising several components: separation of functions, separation of agencies, separation of persons and a form of relations between the powers. Let us elaborate on each of these components and examine them from the perspective of deliberative democracy.

4.4.1 Separation of functions

There are two types of separation of functions; one of them is usually overlooked. We have distinguished between the protective function of the state and its productive function. The protective function is connected mainly, but not exclusively, to the constitutional stage and the binding force it exercises upon post-constitutional collective processes; the productive function is related mainly to the post-constitutional stage (Buchanan, 1975, pp. 68-70). From a theory of a state point of view this distinction should be considered as the more important grounds for separation of functions.
A second functional division of central government is between rule making, rule-application and rule-adjudication, or, as they are more commonly called - legislation, administration and adjudication. History reveals that this functional division has always existed, regardless of the era (or at least long before the doctrine of separation of powers was under discussion) and type of regime (Montesquieu, 1748, Book I, section 3). This phenomenon also has an 'economic' logic: governing according to rules, their application and their enforcement, rather that making each decision individually and independently, is more efficient. It minimizes transaction costs from the point of view of the government or of the decision-makers, as it is cheaper to apply a rule than to deliberate every question from first initials principles. It also minimizes agency costs from the viewpoint of the citizens, namely the exercise of individual control over the government, by providing certainty and predictability (Brennan & Buchanan, 1985, chs. 6-8).

The primary division - between the protective and the productive functions – is a direct consequence of the shift from consensus to majority rule. If, thanks to technological advancement, a greater share of collective decisions can be reached by consensus rather than by majority vote even in the post-constitutional stage, or in the realm of the productive function of the state, than this separation of functions looses its magnitude. In other words, if post-constitutional collective decisions can be reached thorough direct votes (rather than votes of representatives) using unanimity or super majorities, then the distinction between constitutional and post-constitutional spheres, between the protective role and the productive role of the state, looses its viability. Deliberation, as mentioned above, can also contribute to the increased likelihood to reach decisions by consensus. However the effects of virtual as opposed to physical deliberation are yet to be studied.

The secondary division of functions raises interesting questions concerning the role of deliberation in the execution and enforcement of rules. Jurisprudential position will have significant implications on this issue. For a legal formalist who holds that rules can be applied in a clear-cut way and solution to any dispute, or indeed for a modern non-positivist, like Dworkin (1986), who holds that there is one correct answer to every legal question, deliberation may not play a crucial role in adjudication. For a positivist who holds that judges do have discretion after the application of the existing legal
norms, deliberation might have a crucial role. Studies from social psychology mentioned in section 2 are relevant to this point. For example, they can shed light on questions relating to bench conduct: would a better judicial outcome is achieved when three judges act as a nominal group (no deliberation) or as an interactive group. As noted, the experimental findings are not conclusive, but upon decisive research findings it might be desirable to introduce some procedural rules for a judicial panels.

4.4.2 Separation of Agencies – constitutional versus post-constitutional organs

There is a long way, both historically and conceptually, between mere separation of functions and the separation of agencies. The latter principle has a significant effect on the structure of government, because, according to it, not only do the three functions - legislative, executive and judicial - exist, but they ought to be carried out by separate institutions or branches of government. Before discussing this type of separation of agencies, however, let us spare a few words on the separation of agencies aspect of the earlier distinction between the protective and productive functions of the state.

A careful look at the role definition of the protective and the productive functions will result in the conclusion that corresponding separation of agencies is necessary due to the conflict that arises between the two functions. While the protective state is aimed at enforcing the initial contract - the constitution, the productive state is engaged in activities involving production of public goods for which the costs are shared by the individuals, and hence involve re-allocation of resources. Conflicts between the outcomes of the productive state and the basic contract are, therefore, to be expected. The productive state will tend to overstep the boundaries of the initial contract, aiming to reach its “technical productive frontier” (North in Elster 1986; Eggertson 1990, pp. 319-328). This may be worsened by principal-agent problems between the government and the people, interest-group politics and rent-seeking activities (Gwartney & Wagner 1988, pp. 17-23; Eggertson 1990, pp. 350-353). The protective state will not take into account the benefits of any one alternative against its opportunity costs, and its outcomes will not necessarily be the set of results which best represent some balance of opposing interests (Buchanan 1975, pp. 68-70). Even if the productive state will be guided by utility maximization or wealth maximization, it will not compensate those who become worse-off from the decisions, because their vote will not be needed to pass
decisions (unlike the case when unanimity is required for passing a decision). For these reasons it would be desirable to separate the agencies assigned to fulfill the protective and the productive functions.

Legislative bodies are the main institutions of the productive state. Separating between the protective and productive agencies means that parliaments should not be given constitutional-making powers. The constitution is aimed at limiting the powers of the parliament, and it is likely to fail if it is drafted and approved or amended only by parliament.

In the post-constitutional stage, the protective function is of judicial nature, and in most Common Law countries it is indeed assigned to the judiciary; but it is distinguishable from the role of the judiciary within the productive state. Indeed, in many Civil Law countries the protective function is assigned to a body entitled “constitutional court”, which is not perceived to be part of the ordinary judiciary. This distinction between the regular courts system and the constitutional court makes sense vis-à-vis the rationales for separating agencies of the productive and protective states. While the constitutional court has to be independent from the post-constitutional organs of the state, but accountable to the people, the regular courts whose main task is to adjudicate disputes between individuals, have to be independent from the public, but less so from the post-constitutional organs of government.

In many countries in which a constitutional court is an independent organ separated from the regular judiciary, the laws regulating the composition of the court implicitly reflect incentives for deliberation. In the French constitutional court, for example, there are 9 justices, 3 of whom are appointed by the legislature, 3 by the President and 3 by the judiciary. This creates a diversified group, representing different voices of society. Variations of this model exist in many other European countries. Indeed, the outcomes of European constitutional courts in the past decades took a very different direction from, for example, the American Supreme Court in its constitutional enforcement capacities. We are again in a very infertile field regarding empirical studies on the sources of the differences and how deliberation facilitated by the composition of the court affects the differences, adding yet another topic awaiting further research.
4.4.3 Separation of Agencies – legislature, executive, judiciary

Let us return to the more familiar separation of agencies between the legislature, executive and judiciary, which can be seen as a division of powers within the productive state. The productive state can be perceived, from a microeconomics perspective, as a micro-decision unit (like a firm) or perhaps as a set of micro-decision units (like an industry), producing primarily public goods. In this context separation of agencies is connected to the monopoly problem (Silver 1977; North in Elster 1986; Whynes & Bowles 1981, ch. 5). The concentration of all governing powers in the grasp of one authority creates a vertically integrated state, which has monopoly powers, or even discriminating monopoly powers. Monopolies cause inefficiency and a distorted division of wealth between producers and consumers, i.e. in the case of the state - between the government and the citizens.

There are several possible ways to promote competition in the case of the state as a monopoly: the existence of other states, to which it would be possible to emigrate, namely the “exit” option (Hirschman 1970), a federal structure (Tullock 1969; Posner 1987, Mueller 1996, ch. 6), and the separation of agencies. These forms of promoting competition can be regarded as substitutes. Thus, a more accessible exit option can soften the need for separation of powers. Likewise, a federal state weakens the need for a rigid separation of powers.

Separation of agencies, when it is vertical (separation of agencies within the central government) rather than horizontal (federalism), can, in fact, also increase the monopolistic powers of the government vis-a-vis the general public, by diminishing the quantity of public goods produced (Brennan and Hamlin 2000, chs. 11 & 12). In other words, when a monopoly is broken up to several firms, each producing a different ingredient of the final product, the monopolistic exploitation of the consumers rises. Only competition in the production of the same ingredients achieves the desirable results. Thus, separation of agencies itself does not guarantee desirable results from the point of view of the public wellbeing. Only certain kinds of separation – in which the separated organs are fulfilling together some overlapping functions – will achieve the desirable results. This component will be discussed in the last point of this skeleton argument.
There is another important rationale for separation of agencies - diminishing agency costs. As we have seen above, the democratic system is a kind of a compromise or a second best, which is the result of the need to transfer powers from the people to a central government, and at the same time place the government under the control of the people, in a way that is not too costly. In this sense it was probably appropriate to describe democracy as the least bad system of government. The main problem of the transmission of powers to a central government, leaving only periodical control in the hand of the citizens, is agency costs, which are caused by the differences between the incentives of the agents – the politicians, and the incentives of the principals - the citizens.

There are three typical categories of costs involved in a principal-agent relationship: bonding costs, monitoring costs and residual loss (Jensen & Meckling 1976). In the case of central government (agent) and citizens (principals) the residual loss is the dominant element. This loss is created by the mere fact that the rulers-politicians seek to maximize their own utility by gaining more powers, instead of maximizing the population's well being (Michelman 1980, Backhous 1983). One way to reduce these agency costs is to divide the agency into separate sub-agencies, creating different incentives for each. In that way, while legislators act to maximize their political powers and chances of re-election, administrators and judges have different incentives, as a result of different institutional arrangements. If this is the case, the reduction of agency costs would be more significant if the division of powers would not only be by separation of agencies but also by assigning each agency a different governing function (Macey 1988). Here we are getting closer to the classical idea of separation of powers.

The economic history analysis (e.g. of North 1981) of the political changes in seventeenth and eighteenth-century Europe, among them the emergence of separation of powers, is a particular example related to the theoretical explanation above. In a nutshell, this explanation focuses on the financial crises of the early nation states, which brought the rulers (the monarchs) to seek loans from the public. One of the methods to gain the confidence of the lenders in the government's commitment to honor its credit was the creation of other governmental agencies, including an
independent judiciary, which were to enforce these contracts in an impartial manner. The emergence of representative government is also associated with this explanation.

4.4.4 Separation of Persons

Separation of persons is the third fundamental element in the pure doctrine of separation of powers (together with separation of functions and separation of agencies) and the most dramatic characteristic of it (Marshall 1971, pp. 97-100). This element was, in fact, already incorporated into our analysis of separation of agencies, because economic analysis is based on individuals and their rational-personal choice. This choice (or the utility function) is crucially dependent upon exogenous circumstances. Thus, choices made by government personnel are dependent upon the branch of government in which they work. In other words, in the context of economic analysis there is no meaning to establishments and institutions without their human operators; as there is no meaning to the analysis of individuals’ behavior without the examination of the institutional arrangements and incentives mechanism to which they are subject. Thus, separation of agencies is meaningless unless separation of personnel is an integral component of it.

What we have just said does not mean that only lawyers should be part of the judiciary and that only bureaucrats should work in the executive. There are legal systems (especially in Continental Europe) in which a mixture of professionals in the different branches of government is encouraged, and in the deliberative perspective this indeed might even be better vis-à-vis the goals of democracy. Separation of persons merely means that no one should be part of more than one branch of government at the same time. This is not such a trivial requirement, as it looks at a first glance. In many systems such separation of persons does not exist, when, for example, cabinet members are (and in some systems they are even required to be) also parliament members.

We noted before that separation of agencies might reduce agency costs, which are the result of the government-citizens (agent-principals) relationship. One way of achieving this is different representation structures for each of the branches, which can increase the people's control over the government and the interplay between particular and general issues on the public agenda and between short, medium and long term interests.
Without separation of persons a significant share of these advantages would fade away. The desirability of separation of persons is further derived from the optimal relationships between the powers, as will be explained below. The American system, which uses the advantages of different representation structures is also quite strict about this element of separation of persons. The Vice President is the only official who is part of more than one branch of government.

4.4.5 The Relationships Between the Powers

The most controversial element of the desirable structure of government is the format of the relationships between the separated powers or branches of government. There are at least two distinct, though interrelated, questions here: (1) to what degree separation of powers is advantageous (this question involves the issue of delegation of powers); and (2) what is the degree of freedom or independence that we ought to assign each of the branches. The former question relates mainly to functional separation; the latter relates to institutional separation (separation of agencies). These questions are strongly interrelated in the sense that there could be a great deal of trade off in different combined solutions to them.

Judicial review can serve as a good example. The conventional debate concerning judicial review is usually within the boundaries of the second question: should the legislature and the executive be controlled by the judiciary, and if so, to what extent? But this issue could also be raised in the framework of the first question. In this context we would first ask whether judicial review is part of the legislative or the judicial function. If it is seen as part of the legislative function, we will have to ask whether the allocation or rather delegation of the powers to participate in rule making to the judiciary is desirable or legitimate (Salzberger 1993).

The two extreme approaches to the second question are the independence approach or the pure doctrine of separation of powers, on the one hand, and the checks and balances approach, on the other hand (Yasky 1989; Vile 1967, ch. 1; Marshall 1971, pp. 100-103). Analytically these two approaches can refer to the functional level, which is directly related to the first question about sharing powers (or delegating powers), or to
the institutional and personal levels, i.e. the accountability of agents in each branch to those in the other branches, or to both levels.

It is possible, for example, to argue that an optimal structure of separation of powers would adopt the checks and balances doctrine with respect to the functional level, and the independence doctrine with regard to the personal level. This is the underlining idea behind the form of separation of powers in the USA: on the one hand, almost every collective decision of one of the branches of government is subject to approval or review by the other branches. On the other hand, it is very difficult for one branch of government to remove any of the agents in any of the other branches. Thus, in contrast to popular perception, checks and balances approach is adopted in the USA only on the functional level, while independence (or pure separation) is adopted on the personal level. In contrast, in most European parliamentary democracies, there is no independence on the personal level. The members of the executive are accountable to the legislature and the Prime Minister has the power to dissolve Parliament. Likewise, appointment and promotion of judges is under the power of the executive and/or the legislature. But there is relatively more independence on the functional level. For example, the legislature cannot review appointments within the executive and legislation is not subject to a veto by the executive.

One theoretical framework for analyzing these questions is, again, transaction costs and decision-making costs on the one hand, and agency costs on the other hand. A smaller degree of independence is inclined to raise the former costs but reduce the latter ones, and the optimal level may depend on variables such as the size of the jurisdiction, (Silver 1977), the representation structure of each branch, and more. Technology, as indicated before, is expected to effect this cost-benefit calculation. Current information technologies decrease both transaction costs or decision-making costs and agency cost. Thus, on the one hand, the need for different branches of government balancing and monitoring each other diminishes. On the other hand, the costs involved in such a conduct also decrease.

As to the first question about the degree and rigor of the desirable separation, the solution might be derived from a comparison of costs analysis. This analysis is the second stage in a theoretical hierarchical decision-making model. Let us take for
example the function of rule-making. In the first stage of this model we have to decide on the merits of a substantive issue - whether a certain policy or a decision is desirable at all. In the second stage we have to decide which of the three branches of government can materialize this policy or make the decision most cheaply. The costs include both transaction costs (the costs of the decision-making process) and agency costs (Aranson et al. 1982/3, pp. 17-21). In making general rules we may expect that the legislature would be the most expensive with respect to transaction costs, but the least expensive with respect to agency costs. This might not be the case with minor, secondary or more particular rules, and if this is the case, it is possible to conclude that separation of powers (or, rather, separation of functions) should not be absolute. Cyberspace enables new mechanisms for creating rules and it blurs the distinction between rules and particular decisions, and hence, again, its effect on a theory of the state is in the direction of less rigid separation of powers.

Another consideration, connected to transaction costs of decision-making, as well as to agency costs, which ought to be taken on board when deciding the degree of separation or the degree of functional independence, is the theory of collective decision-making. The theory of Social Choice taught us that, majority rule, which is usually employed by legislatures, might bear grim results of cycling or arbitrariness. One method for ameliorating this situation is to allow additional bodies to take part in the decision-making, bodies that have different decision-making processes, incentives and representation structures. The legislative veto and judicial review in the American system can be seen as performing this task, (Tullock 1981; Aranson et al. 1982/3; Mayton 1986; Moe 1990; Salzberger 1993), and indeed some scholars argue that they were designed for this purpose.

Deliberation might also play a role when considering the optimal model of government, and beside examining the structure of separation of powers that promote deliberation among the principals – the citizens, another form of deliberation is to be added – the one among the branches of government. A pure form of separation will not be conducive to deliberation among the branches, as opposed to a checks and balances model. An important question here is which of the checks and balances model is likely to promote constructive deliberation. Initial intuition seems to point that functional checks and balances, rather than personal or institutional, is likely to promote more
deliberation, as each branch is dependent on the others for the substantive decisions it makes. The current state of US politics is an obstacle to this hypothesis, and indeed, checks and balances on the personal or agency level might achieve similar (and perhaps even better) results, where the threat of removal from office induces deliberation and compromises.

The conclusion drawn from all these considerations is the rejection of the 'pure' doctrine of separation of powers, in favor of some degree of power-sharing and functional dependency. A sharp analysis of the relations between the powers of government was offered by Brennan and Hamlin (2000, ch. 11). They show how “strategic” separation of powers (pure separation) leads to exactly the opposite results from the point of view of the population welfare from “competitive” (check and balances) separation of powers. While the former will reduce the quantity of the public goods supplied to increase government gains, strengthening the monopolistic powers of government and exploitation of the public, the latter will increase competition and will improve the public welfare.