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AUTHOR: STEPHEN HOLMES, EDITOR in CHIEF
UNIVERSITY OF CHICAGO LAW SCHOOL

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1755 Massachusetts Avenue, N.W.
Washington, D.C. 20036

der with the settlements system, bizarre monetary reform and disregard for primary, monetary policy objectives.

The biggest problem is that instead of pursuing just one target for the national currency, the central bank is always maneuvering and even participates in political games. Today, the degree of CBR independence, in practical terms, is unique because it really can do whatever it wishes. That is why we are preparing a new CBR law which will not take the independence away but will give guarantees that a more responsible monetary policy will be followed. This is primarily a question of decision-making procedure within the CBR.

The fate of financial stabilization in Russia

The inflation rate fell to about eight percent in March 1994, the lowest in nearly two years. In January, the new government was so frightened by criticism that it forgot about corrections to the economic policy and acted in quite a monetarist way. The problem is that a financial stabilization policy is still not really embraced by the authorities. The recently declared target of seven-to-nine percent inflation per month by December 1994 is not something with which one can be truly content. What is surprising is that organizations like the IMF agree to such policies.

The latest joint declaration of the government and CBR has some correct points, but there are suspiciously too many points like "we shall not fix prices, exchange rates, etc." Instead, "we shall do this and this." There is still a chance that financial stabilization will be achieved, but the CBR and its monetary policy will have to play a crucial role. I do not think this will happen in 1994, but the foundation stones were laid and recent experience shows that it is possible to have an effective monetary policy in Russia.

Boris Fedorov, former Deputy Prime Minister of Economics and Minister of Finance, is currently a member of the State Duma.

Constitutional Courts and Central Banks: Suicide Prevention or Suicide Pact?

Jon Elster

Constitutions are chains with which men bind themselves in their sane moments that they may not die by a suicidal hand in the day of their frenzy. (John Potter Stockton)
The Constitution is not a suicide pact. (paraphrase of a dissent of Justice Robert Jackson in Terminiello v. City of Chicago, 337 U.S. 1, 37 [1949])

I shall argue that the double-edged suicide analogy applies both to central banks (including, in the US, the Federal Reserve Board) and to constitutional courts (including, in the US, the Supreme Court). On the one hand, these institutions can act as salutary chains on the tendency of democratic majorities to act under the sway of passion or short-term interest. On the other hand, courts or banks (as I shall call them for brevity) may, if unchecked, become dominated by sectarian ideologies that take no account of the public interest.

Currently, strong and independent courts and banks are in fashion, largely because of the influence of the United States and Germany. In Eastern Europe, in particular, institutional and constitutional design owes much to the prestige of the Bundesbank and the Bundesverfassungsgericht. In this paper I sketch some arguments for the currently unfashionable view that very independent courts

and banks may be a remedy more dangerous than the disease. The insulation of courts and banks from parliament and government can be taken too far.

Democracies need to be stabilized by constitutions. Let me define the three key terms in this statement. By democracy I mean a system in which political power derives from majority voting by representatives chosen in free, fair and competitive elections under universal suffrage. By a constitution I mean a set of laws that (i) regulate more fundamental matters than ordinary laws and (ii) are more difficult to change than ordinary laws. The obstacles to constitutional change can take the form of obligatory delays, of requiring a supermajority, or a combination (as in Norway) or tradeoff (as in Finland and Bulgaria) of both. The idea of stabilization can be taken in two senses. On the one hand, one can think of a constitution as a kind of flywheel that, by preventing rapid changes, promotes predictability and long-term planning. In this perspective, it does not matter what the constitution is, only that it is relatively fixed and immutable. On the other hand, one may think of a constitution as a device for collective self-protection or self-binding that prevents the majority from yielding to sudden passions or short-term interests. In this perspective, the substance of a constitution obviously matters very much. In the present paper, I limit myself to stabilization in this second sense.

The idea of self-binding or self-protection has a literal interpretation in the theory of individual behavior, a paradigm case being that of Ulysses who bound himself to the mast to protect himself from reacting to the song of the Sirens. It is far from obvious in what sense this idea can be transferred to the field of constitution making. In the first place, one may cite the late Norwegian historian Jens Arup Seip to the effect that, "In politics people only try to bind others, not themselves." In the second place, there is the obvious fact that even if the founding fathers do in fact want to tie their own hands, they also tie those of later generations. (The often-made proposal of writing periodical constitutional conventions into the constitution has, to my knowledge, never been implemented.) In collective self-binding, that is, the self that binds can be both less and more than the self that is bound. If I nevertheless adopt the fiction or myth that constitutions are collective acts of self-binding, I shall also note the occasions when the fiction becomes too obvious and implausible.

There are two main phenomena that induce individuals and collectivities, perceived now as individuals writ large, to limit their ability to take certain actions in the future. First, they might anticipate that, under certain, generally unknown circumstances, their passions might override their well-considered judgment. I am not talking here about what one might call "standing passions," such as religious or ethnic prejudice. Because these passions are as likely to be present at the constitution-making moment as at later times, the founding generation will not have an incentive to guard themselves against them. Rather, I have in mind the sudden panics, fears, greeds and hopes that can arise in turbulent situations.

Second, individuals might bind themselves to the mast because they know themselves to be subject to dynamic inconsistency. Roughly speaking, this phenomenon can be defined in terms of an inability to stick to past plans. It can arise in one of two ways. On the one hand, individuals who discount the future in a non-exponential manner will invariably find that when the time comes to realize plans laid in the past, they no longer have an incentive to do so. This mechanism is not relevant in the present context. On the other hand, dynamic inconsistency may arise through strategic interaction. As it is easier to illustrate this idea than to define it, consider inflation as an example. Once employers and workers have settled on a nominal wage contract, government reacts by setting inflation at a certain level. Because the government cares both about price stability and employment, it will choose a positive level of inflation, which will reduce real wages and increase the demand for labor. Workers, anticipating this reaction, will then set nominal wages at a level that gives them the real wage at which they are aiming. Exactly the same real wage would have been achieved if (i) the government had announced a policy of zero inflation, (ii) the workers had believed that the government

would implement it and (iii) the government had in fact implemented it. Moreover, that real wage would have been achieved without the costs associated with inflation. However, this policy suffers from dynamic inconsistency. If a policy of zero inflation is announced, workers will disregard it because they know that the government will have an incentive to deviate from it later. The optimal plan—zero inflation—is inconsistent.

If an individual or collective actor is subject to sudden impulses or to time inconsistency *and knows it*, it makes sense to take precautions against these tendencies. Self-binding, while not the only precautionary strategy, seems to be the most important one. In the political context, self-binding can take several forms. To guard oneself against sudden impulses, an obvious precaution is to create delaying devices. These can operate either in the normal political system—bicameral systems are often justified by their "cooling-down" effects—or by writing certain laws into the constitution and making them subject to especially slow and cumbersome amendment procedures. To guard oneself against time inconsistency, one might also envisage two procedures. First, the time-inconsistent agent might write the optimal policy into the constitution and require a supermajority for its amendment. Second, the agent might confer policy-making powers in this area to an independent agent not subject to time inconsistency and endowed with similar constitutional protection.

Constitutional courts and central banks fit naturally into the general scheme I have sketched here. Let me consider them one by one.

Courts

If a constitution is seen as a precommitment device, a court may be seen as its enforcer. More specifically, a court may serve as a restraint on majoritarian passions, notably to prevent the violation of individual rights. Many countries have had or now have an effective constitution without anything like a court to enforce it. Until 1971, this was the case in France. It is still the case in Sweden. This does not imply that government or parliament can freely enact decrees or laws that violate the constitution. If that document is at all taken seriously, violators may incur severe *political* sanctions, similar to those triggered by the violation of unwritten "constitutional conventions." There is nevertheless an enormous difference between countries in which courts are able to set aside decrees and laws on the grounds of constitutionality and those in which they have no such powers. In the former, constitutional interpretation gives rise to a jurisprudence that takes on a life of its own and whose relation to the original text can be extremely tenuous. It would be naïve to say that current practices of judicial review in, say, Hungary, the United States or France simply amount to a faithful enforcement of their constitutions.

In practice one faces the choice between underenforcement and over-enforcement of the constitution. Without a court, clear violations may go unpunished. With a court, legislation may be set aside that on its face is perfectly compatible with the constitution. In such cases, the idea that the court is acting as the agent of self-binding becomes ludicrous. Rather, it is acting as a "third chamber" of parliament. The question, then, reduces to whether underenforcement or over-enforcement is the more serious danger. If judicial activism is the price one has to pay for effective enforcement of the constitution, is the price too high? I return to this question below.

Banks

The constitutional concern with monetary policy is an old one. The American Constitution, for instance, prohibits the states from printing paper money, a clause inspired by the inflationary policies of debt-relief that had been followed in several states. Later such clauses disappeared from constitutions, until reappearing in more recent times and now focusing on the role of the central bank. Although the bank is usually regulated by statute rather than by constitutional provisions, the statutes in many countries have hardened into conventions with quasi-constitutional force. Explicit references to the bank in modern constitutions include the following issues. Who appoints the governor? What is the tenure of the governor? Can the governor be dismissed—and by whom?—before the end of his

tenure? Can the government instruct the governor? Is the bank allowed to lend money to the government? What is the objective of the bank?

Some of these issues can be clarified by taking up again the question of inflation versus employment. Although the desire to create jobs is not the only reason why governments might want to expand the money supply, it is representative of the general issue to be discussed. Remember that policy makers would want to announce a policy of zero inflation, which, however, is not credible. To make it credible, they can follow one of two courses. On the one hand, they might opt for rules rather than discretion and write a specific monetary policy directly into the law or the constitution. This option, on reflection, is either undesirable or unfeasible. A simple mechanical rule, while feasible, would provide too little flexibility for adjustment to unforeseen events. Conversely, a rule that tried to specify optimal responses to all contingencies would be impossibly complex.

On the other hand, they might entrust discretion to an independent central bank rather than to the government. To ensure (i) the real independence of the governor of the bank and (ii) the likelihood that he or she follow the optimal low-inflation policy, a number of measures have been adopted. When the central bank of Norway was created in 1816, it was located in Trondheim, several hundred miles from the capital, in order to ensure its independence from the government. (It is also an interesting fact that many courts are located outside the capital—be it in Brno, Kosice, Karlsruhe or Tartu.) In countries with a dual executive, the bank governor may (as in Hungary) be appointed by the president rather than by the government, on the assumption that he will then be more likely to be conservative rather than activist, that is, place higher weight on price stability than on employment. The constitution may (as in the Czech Republic) explicitly forbid the government from instructing the bank or (as in Norway) require that, if it does so, the fact has to be made public. Furthermore, one may (as in Germany) constitutionalize price stability as the goal of the bank. In the spirit of Thomas Schelling, one may also try to strengthen the bank by taking away some of its powers. Thus to protect the bank from informal pressure by the government, one may (as in Argentina) explicitly forbid it to engage in deficit funding.

It should be added that the reason why politicians might want to insulate the bank from their pressure need not be a high-minded motive to promote the welfare of the country. They might also abdicate simply to be able to shift the blame when something goes wrong. Constitutional courts and the threat of invalidation that they pose may serve similar functions. In his study of the French Conseil Constitutionnel, *The Birth of Judicial Politics in France*, Alec Stone claims that in France "governments may use constitutional arguments as convenient pretexts for abandoning radical measures once promised to party activists." (He observes a similar tendency in Germany.)

The problem with both independent courts and independent banks can be stated very simply: they may run amok. Constitutional scholars and central bankers not infrequently belong to extreme, sectarian and ideological schools of thought. This is especially true, I believe, of central banking, as evidenced in the following comment on monetarist reform: "Can a democratic government credibly commit itself to adhere to a policy no matter what its consequences—to guarantee that the monetary base will not be allowed to grow faster than x percent, even if the optimists should turn out to be wrong, and the policy leads to massive unemployment and idle capacity quickly, and slows down inflation only very gradually? Catch 22: maybe the theory is right, but the only way to test it is to convince people that the government would persist even if it is wrong" (Francis Bates, *The Economist*, March 21, 1981).

Courts, too, can become caught up in ideological attitudes. To take my examples from the United States, the (admittedly somewhat different) "Reagan judges"—Rehnquist, Scalia and Bork—are highly rigid and sectarian, proceeding from first principles with little regard for circumstances and consequences. Now, my argument does not require the reader to agree with my assessment of these particular judges and the courts on which they serve. For my purposes I only require agreement on the

proposition that dogmatic and sectarian judges and courts can and do emerge from time to time. Perhaps the danger is smaller in highly politicized courts such as the French one—but of course political appointments and decisions have other dangers associated with them.

The point is not that independent banks and courts, that can act as brakes on majoritarian pressures, are undemocratic. To the extent that they can be defended as self-binding devices, these institutions emanate from the People no less than do the representative ones. If the People, assembled in a founding moment, decide that the public interest and individual rights are best defended by a system of checks and balances, the decision cannot be opposed on the grounds that it is non-democratic. This characterization of the constitution-making process, is to some extent a myth, as mentioned above. The American ban on paper money was the act of a minority elite protecting itself against the majority rather than of a majority protecting itself against itself. The decision by the French Conseil Constitutionnel to expand its powers of judicial review was taken in direct contravention of the intentions of the founders of the Fifth Republic. With regard to other constitutions, notably the ones recently adopted in Eastern Europe, the characterization does, however, seem apt enough. In such cases, the decision to create strong and independent courts and banks can be criticized only on substantive rather than procedural grounds: that, in addition to (or instead of) their intended effects, they have other, perhaps very dangerous, consequences. Rigid bank governors can create unemployment. Dogmatic courts can delay much-needed reforms.

One response to this predicament is simply to accept the risk. One may argue, that is, that the overall effect of independent banks and courts is positive, and that it would be a mistake to focus on local failures that are bound to arise in any rule-governed system. The other response, which I shall explore here, is to try to retain the benefits without the risks. The obvious way to achieve this goal is to create checks on the checks—to constitutionalize protection against self-protecting devices. In many forms of medical treatment, the remedy against the negative side effects of medication is not to discontinue treatment but to supplement it with other forms of medication that can suppress the side effects.

With regard to the courts, there exist a number of such devices. The most general is the amendment procedure. If the court interprets parliamentary legislation in a direction that parliament finds undesirable, the latter usually has the option of amending the constitution so as to leave no doubt about what it means. But this safety valve is not always available or, if it is, it may be too ineffective. (i) Some constitutions contain unamendable clauses. (ii) In general, the amendment procedure is slow and cumbersome. By the time the constitution is changed, irreversible damage may have been done. (iii) The opposite risk arises if parliament enacts a steady stream of amendments every time the court goes against its wishes. This was for a long time the case in India, and remains the case in Austria, where Parliament even incorporated into the constitution a law regulating taxi driving in Vienna when an ordinary law on this matter had been struck down by the Court.

Consider, more specifically, the United States. In addition to the provision that judges serve only during "good behavior," the appointment procedure—involving both the executive and the legislative—allows for close scrutiny of any possible "suicidal" tendencies of the candidates. History is full of cases in which the behavior of judges, once appointed, proved very different from what their prior behavior had led one to expect. In such cases, there are additional safeguards. For one thing, there is the possibility of packing the court by appointing new judges, as Franklin Roosevelt threatened to do. For another, Art. III of the Constitution assigns jurisdiction to the Supreme Court only "with such Exceptions, and under such Regulations as the Congress shall make." Under a literal interpretation, this clause would enable Congress to emasculate the Court entirely. Not surprisingly, the Supreme Court has eschewed this interpretation, yet the clause may have exercised some restraining influence.

Two of the current East European constitutions embody a very different kind of check on the court. The Romanian Constitution says that Parliament may, by a two thirds majority in each chamber, override a Court ruling on the unconstitutionality of

laws and regulations. The Polish Constitution says that Court rulings regarding the unconstitutionality of laws (not regulations) are subject to review by the Sejm. The Constitution does not require a qualified majority in the Sejm to overrule the Court. These unusual provisions may have several explanations. The Polish clause is taken over from the pre-1989 Communist Constitution, which was built on the (entirely fictional) principle that all power was vested in Parliament. When Parliament revised the Constitution in 1992, this clause somehow escaped revision. It is tempting to believe that Parliament found it hard to give up this important prerogative, thus illustrating the general proposition that it may be unwise to combine the functions of the constituent assembly with the legislative body. (This is not to say that the clause is necessarily bad, only that it was probably adopted for bad reasons.) I know less about the Romanian case, but the same two causes—the Communist legacy and self-serving parliamentary behavior—may have been at work here too.

Given the policy errors of the stagflation era, together with recent theoretical work on time inconsistency and credibility, protection against excessively independent banks is not an equally central issue. There is agreement that mechanical rules à la Friedman will not work. The solution is not to avoid discretion, but to shift it from the government to an independent bank. There is also agreement that because of the possibility of unexpected exogenous shocks, such as the 1973 hike in oil prices, the bank should not give absolute priority to price stability, but also take some account of employment. The theoretical work on the implementation of this mixed objective is not very satisfactory. The seminal article by Kenneth Rogoff (*Quarterly Journal of Economics*, Vol. 100, 1985) simply argues for the selection of a governor known to balance the two considerations in an "optimal" way. This procedure is similar to the screening of judges by the executive and the legislative, and is vulnerable to a similar objection. Bankers, like judges, may turn more rigid and conservative over time. Although *ex ante* screening is indeed indispensable, some form of *ex post* control should also be available. One might allow, for instance, a qualified majority (two thirds, for instance) of Parliament to vote the dismissal of the governor.