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Liberal Constitutionalism, Constitutional Liberalism and Democracy

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1. Introduction: Liberalism and Democracy

In a much discussed article Francis Fukuyama (1989)¹ diagnosed the collapse of the communist empire, in a Hegelian spirit, as the “end of history,” marked by humankind’s final arrival at the definitive institutional solutions to the problems of how to organize its economic and political affairs: market economy and liberal democracy. We know now that the author’s prediction of the history that was to unfold post 1989 was overly optimistic, in particular in not anticipating the destructive force of Islamic fundamentalism, the intricacy of the transition process in formerly communist countries, and the persistence of oppressive regimes in various parts of the world. Fukuyama’s “end of history” account may, nonetheless, contain an important element of truth insofar as it does not appear entirely unreasonable to suppose that the basic institutions of markets and of democracy represent the most workable forms of economic and political organization that humans have discovered in the evolutionary process of institutional experimentation that they have been engaged in throughout history. This, I submit, can be reasonably supposed even if there is still significant uncertainty about which specific institutional frameworks make markets work best in the service of human wellbeing and which specific institutions of democratic politics provide the best solution to the problems that are inevitably inherent in collective political choice. And it can also be maintained in spite of the hostilities and resistance that, in many parts of the world, the institutions of markets and democracy are still facing by those who see them as threats to cherished beliefs or to their own established privileges.

Even if the current financial crisis has refueled traditional anti-capitalist sentiments and anti-liberal rhetoric, the global trend that Fukuyama’s account was meant to capture is an encouraging sign for the future of liberalism, at least as far as the market-part of his account is concerned. Functioning markets with their protective institutions are to be found today in more places throughout the world than in past centuries. How far the spreading of democracy

¹ The article was later expanded into a best selling book (Fukuyama 1992).

promises to advance the case of liberalism may seem a much more uncertain question, though, in light of the fact that the growth of the modern welfare state with its many restrictions on individual liberty has been a typical concomitant of the rise of democratic rule. Indeed, this fact has led some advocates of classical liberalism to suspect “that there is an inherent tension between liberty and democracy.”²

F.A. Hayek, arguably the most forceful defender of classical liberalism in the past century, has voiced a different opinion. He has pointed out that we need to distinguish between different concepts of democracy, in particular between – as he calls it – the “basic ideal of democracy” (Hayek 1979: 1) and the specific institutional forms in which this ideal has been implemented in the past. Specifically Hayek (1973:1) has contrasted “a conception of democracy according to which this is a form of government where the will of the majority on any particular issue is unlimited” with a *constitutional conception of democracy* that, while recognizing the principle of the “sovereignty of the people,” insists on the role of a “limiting constitution,” i.e. the requirement “that all authority is restrained by long-run principles which the opinion of the people approves” (Hayek 1979:102). Hayek's assertion is, in brief, that while an inherent conflict does indeed exist between liberalism and *unlimited* democracy, liberalism can be reconciled, and must be reconciled, with the ideal of a constitutionally limited democracy. Hayek's two major treatises, *The Constitution of Liberty* (1960) and *Law Legislation and Liberty* (1973; 1976; 1979) can be viewed as contributions to the project of outlining a liberal constitutionalism that reconciles the ideal of liberalism with the fundamental ideal of democracy.

I concur with Hayek's view on the need to reconcile the ideals of liberalism and democracy (Vanberg 2008). Indeed, I suppose that the future of liberalism will depend on its ability to present itself as an outlook at politics that is compatible with the fundamental ideal of democracy. This claim is based on the conviction that, even if its specific institutional realizations may vary considerably, and continue to evolve, democracy in the generic sense, i.e. as a system of self-government, is the most sustainable form of government. It is based on the conviction that there is no intellectually defensible alternative to the basic democratic principle that the members-citizens of a polity are the ones on whose behalf political authority is exercised and to whom the exercise of such authority must be held responsible. And, most importantly for the purposes of this paper, it is based on the conviction that no other concept of legitimacy in politics can be compatible with the normative principle on which liberalism ultimately rests: the principle of individual sovereignty.

² This is how R.G. Holcombe (2006: 310) describes the message of his book *From Liberty to Democracy* (Holcombe 2002).

The purpose of this paper is to lay out arguments in support of the above claim by distinguishing between two liberal perspectives on constitutional rules, two perspectives that, as I shall seek to show, complement each other and can only in combination constitute a coherent and internally consistent liberalism. This is, on the one hand, a *liberal constitutionalism* that focuses on the need "to provide institutional safeguards of individual freedom" (Hayek 1973:1). And this is, on the other hand, a *constitutional liberalism* that focuses on the need to respect the principle of individual sovereignty at the level of constitutional choice. My principal argument is that by extending its ideal of individual autonomy to the level of constitutional choice liberalism can be reconciled with the "basic ideal of democracy."

2. Private Autonomy and Liberal Constitutionalism

"A constitution that achieves the greatest possible freedom by framing the laws in such a way that the freedom of each can coexist with the freedom of all." This quotation from Immanuel Kant's *Critique of Pure Reason* appears as epigraph in the third volume of Hayek's *Law, Legislation and Liberty* (1979: v), a treatise that, as its subtitle says, is meant as "A new statement of the liberal principles of justice and political economy." A society that is based on the liberal principles that Hayek seeks to restate is a society of sovereign individuals who live peacefully together in mutual respect of each other's rights. These rights are defined by socially sanctioned general rules, rules that protect an "assured private sphere" (Hayek 1960: 13) within which individuals are free to choose as long as they do not interfere with the rights of others. The liberty individuals enjoy in the liberal society is "freedom under the law" (ibid.: 153), liberty "limited only by the same abstract rules that apply equally to all" (ibid.: 155).³

Liberty as assured private sphere under the law is captured by the concept of *private autonomy*. Private autonomy means autonomy of the individual within the limits of the rules of law. It is the liberty individuals enjoy as private law subject within an effectively enforced *private law system* "protecting a recognizable private domain" (Hayek 1967a: 162). And a free society in which individuals enjoy such private autonomy can properly be called *private law society*.⁴ As autonomous private law subjects, individuals are free to enter in voluntary

³ Hayek (1960: 19): "Liberty is ... a condition in which all is permitted that is not prohibited by general rules." - Hayek (1979: 111): "Individual liberty ... requires that coercion be used only to enforce the universal rules of just conduct protecting the individual domains and that the individual can be restrained only in such conduct as may encroach upon the protected domains of others."

⁴ Franz Böhm, co-founder of the Freiburg School of Law and Economics (Vanberg 1998), speaks of the liberal society as "a private law society consisting of equally free people with equal rights" (Böhm 1989: 54; 1980: 140). Commenting on Böhm's contribution Hayek (1967a: 169) has noted that Böhm "described the liberal order

contractual relations with other equally free persons. Coordinating their social affairs by voluntary contracts they are able to realize the mutual benefits that can be had from voluntary cooperation. As M. Rothbard (1970: 77) puts it, the liberal private law society is a “*contractual society*”, a society organized in terms of “freely entered contractual relations between individuals” (Rothbard 1970: 77).

The paradigm case of mutually beneficial cooperation between autonomous private law subjects is bilateral market exchange, an exchange that is based on *voluntary* agreement of the transacting parties,⁵ with the attribute ‘voluntary’ implying that the agreement is free from coercion and fraud.⁶ By voluntarily agreeing to the transaction both parties indicate that they expect to benefit from it.⁷ In an uncertain world their expectations, to be sure, need not necessarily come true. Yet, even if, *ex post*, in light of new information, parties to an exchange may regret their choice to enter into the exchange – just as, *ex post*, they may regret other choices they voluntarily made – the transaction must still be regarded as legitimate as long as the original agreement was given in the absence of coercion and fraud. To allow individuals to choose free from coercion and fraud is the function of the rules of the private law system, rules that draw the demarcation line between strategies that are permissible in interpersonal dealings and strategies that are prohibited as illegitimate ‘coercion’ and ‘fraud.’ In a world where all human interaction is about seeking to induce others to do things that the inducing party desires – in fact, behind every exchange offer is the intention to induce others to do something in return – rules that draw such a demarcation line are, quite obviously, essential for a functioning social order.

What we call a market is nothing other than a system of voluntary exchange. M. Friedman (1962: 13) speaks of “voluntary co-operation of individuals” as the “technique of the market place.” In order to function as an arena of voluntary exchange the market requires an institutional framework, namely the private law system, that defines property rights and specifies what qualifies or does not qualify as a ‘*voluntary*’ agreement. As J.M. Buchanan (1979: 31) puts it, the ‘market’ is “the institutional embodiment of the voluntary exchange processes that are entered into by individuals in their several capacities.” In similar terms Franz Böhm (1989: 54; 1980: 124) notes that “the functioning of the free market presupposes

very justly as the private law society.” – For a more detailed discussion of Böhm’s concept of the *Privatrechtsgesellschaft* or *private law society* see Vanberg 2007b.

⁵ Rothbard (1970: 72): “The major form of voluntary interaction is voluntary interpersonal exchange.”

⁶ As Rothbard (1970: 71) notes, the free society is „a society based on voluntary action, entirely unhampered by violence or threat of violence.”

⁷ Friedman (1962: 13): “The possibility of co-ordination through voluntary co-operation rests on the elementary ... proposition that both parties to an economic transaction benefit from it, provided the transaction is bi-laterally voluntary and informed.”

the existence of the private law society.”⁸ In fact, as Böhm has argued, the private law society and the market economy are twin sisters in the sense that markets are nothing but the networks of economic relations that result from the freedom of choice that individuals enjoy in a private law society.⁹

While bilateral market exchange is the paradigmatic instance of mutually beneficial cooperation it does by no means exhaust the possibilities that exist for private law subjects to realize mutual gains from voluntary cooperation. Cooperation for mutual benefit includes all contractual arrangements that autonomous individuals voluntarily enter into, such as, for instance, private associations, clubs, business enterprises, religious communities, and other kinds of corporate arrangements. It includes arrangements of multilateral exchange that individuals conclude in order to produce collective or club-goods, such as, for instance, a neighborhood swimming pool, arrangements in which everyone commits to contributing his share under the condition that all other participants contribute their share as well. It includes arrangements of team-production, such as the forming of a business enterprise. And it includes, in particular, arrangements whereby groups of individuals seek to realize mutual gains by jointly committing to rules that impose specific constraints on their future freedom of choice, such as the homeowners in a neighborhood agreeing on certain rules for how to maintain their property.¹⁰

The important difference between ordinary bilateral or multilateral exchanges and joint commitment to rules is that the former are about one-time transactions while the latter are about limiting one’s freedom of choice for a future – limited or open-ended – period. By contrast to pure exchange contracts the latter are social or constitutional contracts in the sense that they are about a group of persons jointly imposing certain rule-constraints on their future choices. The “freedom to impose restrictions on one’s future behavior” (Goldberg 1976: 428) is part of the freedom of contract in the private law society. As long as such contracts are concluded voluntarily between autonomous private law subjects they must be considered legitimate even if they imply severe restrictions on the participants’ freedom of choice.¹¹ As I. Kirzner (1994: 105f.) puts it: “Where cooperation is of a real or imagined mutual benefit to a

⁸ Böhm (1989: 53; 1980: 121): “The exchange agreement and its fulfillment is the characteristic mode of cooperation between independent traders with equal rights. In this respect, therefore, the private law system is very decisively involved in controlling the free market process.”

⁹ The title of Böhm’s (1980) major contribution on the subject is “Privatrechtsgesellschaft und Marktwirtschaft” (Private Law Society and Market Economy).

¹⁰ As Buchanan (1979: 32) notes, such arrangements can be looked at as „cooperative trading arrangements which become merely extensions of the market as more restrictively defined.”

¹¹ What should be added here is the qualifying condition “as long as the contracting parties maintain their status as autonomous private law subjects.” This proviso excludes slavery contracts as legitimate contracts, even if the enslaved party were to agree voluntarily to the contract.

group of individuals, the market will of course provide scope for such cooperation. The market does, as has often been recognized, make it possible for groups within it to organize themselves in communes or other organizations on strictly socialist principles, if they choose (This, let us not forget, is how capitalist firms come into existence.)” Again, what legitimizes such organizational arrangements is the voluntary agreement among the participating individuals, whereby what counts as ‘voluntary’ is to be judged in terms of the rules on which the private law society, within which they are concluded, is based.

If the rules upon which the private law society is based were self-evident and self-enforcing the ideal liberal society might be imagined as an ‘ordered anarchy,’ a social order that functions without a coercive apparatus of enforcement, based only on contractual arrangements among private law subjects. While such vision of a self-sustaining private law society may be an attractive conceptual benchmark, a realistic outlook at human nature and at a world where incentives to cheat on the rules of the game are omnipresent requires one to acknowledge the need for an “authority that has the necessary power” (Hayek 1960: 139) to enforce the rules, i.e. the need for a “social apparatus of compulsion and coercion that induces people to abide by the rules of life in society, the state” (Mises 1985: 35).¹²

A liberalism that recognizes the need for government to enforce the rules on which the private law society is based is inseparable from *constitutionalism*. It recognizes that individual liberty as private autonomy needs constitutional protection in a double sense. It needs to be protected by the private law system as the ‘constitution’ of the private law society. And it needs to be protected by a ‘constitution’ in the standard sense, i.e. by a system of rules that limits the power of the agency that is supposed to enforce the private law system, the state.¹³

Hayek (1973: 1) speaks of a “liberal constitutionalism” the chief aim of which is “to provide institutional safeguards of individual freedom” and “to secure individual liberty by constitutions.”¹⁴ A constitution in the standard sense is, as he notes, “essentially a superstructure erected over a pre-existing system of law to organize the enforcement of that law” (ibid.: 134). The “pre-existing system of law” of which Hayek speaks comprises the universal rules of conduct, codified in the system of private law, that allow the private law

¹² Friedman (1962: 25): “However attractive anarchy may be as a philosophy, it is not feasible in a world of imperfect men.” – Mises (1985: 39): “It is a grave misunderstanding to associate (liberalism, V.V.) in any way with the idea of anarchism. For the liberal, the state is an absolute necessity.”

¹³ Hayek (1960: 182): “A free society certainly needs permanent means of restricting the powers of government.”

¹⁴ About his treatise *Law, Legislation and Liberty* Hayek (1979: 41) says that it “mainly concerned with the limits that a free society must place upon the coercive powers of government.”

society to function, and the “superstructure” is the system of “rules of the allocation and limitation of government comprised in the law of the constitution” (ibid.).¹⁵

3. Constitutional Liberalism and Individual Sovereignty

Liberal constitutionalism is concerned with individual liberty as private autonomy. It is about “the recognized rules of just conduct designed to define and protect the individual domain of each” (Hayek 1979:109) and about the constitutional provisions that are needed to limit the use of the coercive powers that are entrusted to the state in order to enforce these rules.¹⁶ Liberty as private autonomy means freedom of choice within the protected individual domain, within the assured private sphere. Its substantive content depends on how the socially enforced universal rules of conduct, or the rules of private law, are defined. These rules can and do differ, however, among different societies, and they have changed and continue to change over time. Accordingly, what liberty as private autonomy means in substance varies in content across societies and through time. This raises the question of how different systems of rules – systems of rules that, by implication, define ‘individual liberty’ differently – can be compared.

Since individual liberty as *private autonomy* can only be specified in terms of an existing private law system that defines its content, it can, quite obviously, not serve as the standard against which alternative private law systems themselves can be judged. As a criterion the content of which depends on what the existing system of rules defines as assured private domain it can only serve as an internal standard, applicable within a rule system, but not as one that could be applied across such systems. Yet, the ideal of individual liberty is not meant – and has surely not been meant by the founders of classical liberalism – as a normative criterion that can be applied only *within a given rule system*, but, instead, as an ideal that can also serve as a standard against which systems of rules themselves can be judged. Interpreted in this sense, i.e. as a standard for judging alternative systems of rules, the term ‘liberty’ can, quite obviously, not have the same meaning as ‘private autonomy.’ The ideal of ‘liberty’ as freedom of choice *within given rules* cannot be the same as an ideal of ‘liberty’ that is meant as a standard for judging the very rules that define the substance of private autonomy.

Understood as a normative criterion for judging alternative systems of rules, the ideal of liberty can essentially be interpreted in two alternative ways. Either in terms of a

¹⁵ Hayek (1973: 131f.) “The distinction between universal rules of just conduct and the rules of the organization of government is closely related to, and sometimes explicitly equated with, the distinction between private and public law.”

¹⁶ Hayek (1978a: 109): “The limitation of all coercion to the enforcement of general rules of just conduct was the fundamental principle of classical liberalism, or, I would almost say, its definition of liberty.”

substantive criterion, i.e. as a criterion that allows one *directly* to judge alternative rules in terms of their nature or content. Or as a *procedural criterion*, i.e. as a criterion that judges rules *indirectly* in terms of the procedure by which they come about or from which they derive their legitimacy. The claim to provide a substantive criterion is, for instance, made by authors who take recourse to the concept of ‘natural rights’ as the standard against which existing rule systems should be judged. Such constructs provide, however, only a seeming solution to the problem that is at stake. They are of little help where there is disagreement on what should be regarded as ‘natural rights’ and where no unquestioned authority is recognized that can decide what these rights are. In a society of free and equal individuals with differing opinions on what ‘natural rights’ are, its members must somehow come to terms with each other in defining the rules according to which they want to live together. Comparable problems arise if the concept of ‘natural rights’ is meant to denote evolved rules that antecede deliberate codification and legislation. That all existing rule systems have been anteceded by evolved rules of conduct, and that in this sense “government never starts from a lawless state” (Hayek 1979: 123), is undoubtedly true.¹⁷ Yet, in a world where evolution has produced different kinds of rules, evolved rules can decide what is ‘right’ only in their respective context of origin, but cannot serve as a standard to be applied across societies with different traditions. Furthermore, even in the environment in which they evolved they can serve as normative standard only so long as they are unquestionably respected within the respective group. In a society where they have lost their status as unquestioned and unquestionable standard free and equal individuals cannot escape the need to settle among themselves which rules they are jointly to submit to.¹⁸

Interpreted as a *procedural criterion* the ideal of liberty focuses on the issue of what legitimizes a system of rules that is to govern the relations among sovereign individuals. Instead of seeking to directly judge the nature or content of that system by applying a pre-given standard of ‘rights,’ a procedural interpretation of the ideal of liberty views the individuals to whom the rules are to be applied as the source from which rules need to derive their legitimacy. Such a procedural approach to the ideal of liberty posits that, just as voluntary contracting among private law subjects *within* a framework of rules legitimizes the

¹⁷ As Hayek (1973: 82) notes in reference to idea of the evolution of law: “Perhaps one might even say that the development of universal rules of conduct ... (began) with the first instance of silent barter when a savage placed some offerings at the boundary of his tribe in the expectation that a return gift would be made in a similar manner, thus beginning a new custom.”

¹⁸ Hayek (1960: 158) acknowledges the absence of an immutable external standard of ‘rights’ when he notes: “What exactly is to be included in that bundle of rights that we call ‘property,’ especially where land is concerned, ... what contracts the state is to enforce, are all issues in which only experience will show what is the most expedient arrangement.”

social arrangements individuals enter into, so voluntary agreement among sovereign individuals legitimizes the rules to which they jointly submit. By contrast to the ideal of *private autonomy within pre-defined rules*, this ideal of individual liberty is about *individual sovereignty in defining the rules* under which a group of persons chooses to live, rules that among free and equal individuals can only be chosen by voluntary agreement.

The concept of individual sovereignty in constitutional choice raises the question of how liberty, and thereby voluntary agreement, can be understood at the constitutional level, i.e. at the level where a group of persons collectively decides on the rules they are to submit to. As indicated before, this question does not pose any difficulty as long as constitutional contracts are concluded within a pre-existing private law system that protects individual rights. Individual liberty and voluntariness in contracting are here defined in terms of the existing ‘rules of the game.’ This is why a liberal constitutionalism can allow for all kinds of constitutional arrangements that are concluded within a private law framework, even if in content these arrangements may restrict severely the participants’ freedom of choice. It faces difficulties, though, where rule-systems are to be judged for which no more inclusive framework of rules exist with reference to which what individual liberty and voluntary agreement mean could be specified. This is typically the level of the nation state that defines and enforces the rules to which its citizens and those who reside or operate within its territorial boundaries are subject.¹⁹ The challenge for liberalism is to specify its ideal of individual liberty in a way that is applicable at this level.

My principal conjecture is that in order to meet this challenge *liberal constitutionalism* needs to be supplemented by a *constitutional liberalism* that extends the normative principle that is implied in the ideal of individual liberty, specified as private autonomy, to the constitutional level, i.e. the level where the rules are defined that, in turn, define the content of what constitutes private autonomy. The essence of the liberal ideal of private autonomy is the notion that *voluntary agreement* among sovereign individuals should be the principal mode of social coordination. It is this very notion that legitimacy in social matters derives from voluntary agreement among the participating individuals that must, I submit, be regarded as the basic normative principle on which the ideal of liberalism rests. The principle of *private autonomy* specifies this norm with regard to the *internal functioning* of the private law society. In its more general interpretation the notion of the legitimizing role of voluntary

¹⁹ Beyond the level of the nation state a constitutional framework exists only insofar as international conventions or covenants, such as a charter of universal human rights, are in force and recognized that define individual rights in a way that may serve as a reference point for what ‘liberty’ and ‘voluntariness’ requires at the level of the nation state. Such supra-national rule-systems would, of course, themselves be subject to the question of where they derive their legitimacy from.

agreement can, however, also provide a criterion for evaluating the legitimacy of the rules of private law that constitute private autonomy. Looked at in this way the ideal of *private autonomy* is simply a specification of the more general normative principle of *individual sovereignty*, the principle that legitimacy in social matters, including the legitimacy of the rules of private law themselves, derives only and exclusively from voluntary agreement among the persons involved.

A liberalism that consistently adheres to the principle of individual sovereignty must regard as “legitimate” at the political-constitutional level no less than at the sub-constitutional level of market choices whatever the individuals involved voluntarily agree upon. To be sure, the test of “voluntariness” cannot be quite the same at both levels, at the level of private autonomy and at the level of constitutional choice. In the realm of private autonomy the rules of law imply a definition of what counts as “voluntary,” a definition that can be adjudicated. At the constitutional level the relevant meaning of “voluntary contracting” is clearly more difficult to specify. This does not alter the fact, however, that a consistent liberalism must consider voluntary agreement as legitimizing principle at the level of constitutional choice – whether this “choice” is the product of a spontaneous process or of deliberate, legislative procedure – no less than at the level of private autonomy. The challenge to a consistent liberalism is to give an answer to the question of how – in recognition of the difficulties that are unavoidably inherent in the nature of collective, political choice – individual sovereignty and voluntariness in contracting can be defined in the most meaningful way, and be secured most effectively, at this level. The way to meet this challenge is to develop a liberal concept of democracy that starts from the recognition that the fundamental ideal of liberalism and the basic ideal of democracy are not in conflict but in harmony with each other.

4. Democracy and Citizen Sovereignty

While the deficiencies of modern democratic politics have often been criticized from within the liberal paradigm, the liberal research agenda has, unfortunately, remained comparatively silent in regard to the *positive* question of how the political process might be organized so as to implement the principle of individual sovereignty at the constitutional level, accounting for the specific constraints that are inherent in the nature of politics. In a world in which the utopia of a private law society without the state cannot be realized this issue must however be addressed by a liberalism that wants to offer a consistent outlook at both, the private realm and the public, political realm of human social life.

The common practice of identifying democracy with majority rule distracts from the fact that we must distinguish between the basic ideal of democracy and the particular institutional forms in which it is practiced. It is in reference to the basic ideal of democracy when John Rawls (1971: 84) speaks of a democratic society as “a cooperative venture for mutual advantage” and when he describes “democratic citizenship” as “a relation of free and equal citizens who exercise ultimate political power as a collective body” (Rawls 1999: 577). In this understanding a democratic polity is a *citizen cooperative*, an association that free and equal individuals form to undertake joint projects that they expect to serve their common interests. And the freedom of choice that individuals jointly exercise in organizing a citizen cooperative I propose to call, as counterpart to the concept of private autonomy, *citizen sovereignty* (Vanberg 2007a).

There is an obvious symmetry between the ideal of democracy as citizen cooperative and a constitutional liberalism that focuses on the liberty of sovereign individuals as private law subjects to agree on constitutional contracts that limit their post-constitutional freedom of choice. Both are based on the normative premise that individuals arrange their social relations as equals through voluntary contract and that their contractual agreement is the only source from which legitimacy in social matters can be derived. In other words, both adopt a contractarian-constitutionalist outlook at human cooperative arrangements.²⁰

The concept of democracy as cooperative venture for mutual advantage suggests that, notwithstanding the obvious differences that exist between the two kinds of cooperative organizations, democratic polities can be compared to cooperative arrangements that

²⁰ Because the contractarian-constitutionalist outlook at politics is often associated with the notion of an original contract behind a veil of ignorance or uncertainty a qualifying comment may be in place here. Though this conceptual construct may be useful for some purposes, it can easily be misleading because it tends to focus unduly on the legitimizing role of *original* agreement while distracting from the normative significance of *ongoing* agreement (Vanberg 2003). The relevance of this distinction can be shown by comparing democratic polities and private voluntary associations. The latter can typically look back on a recorded history that can be traced to their very origin in a voluntary contract signed by their founding members. Yet, whether or not this is the case, is entirely irrelevant in judging the legitimacy of an association’s current operation. What is of relevance for the legitimacy of its internal operation (the issue of the legitimacy of its external operation is to be judged in terms of the more inclusive institutional environment) is the voluntary acceptance of the association’s constitution by its current members. To the extent that its current members have joined an association voluntarily and keep up their membership by voluntary choice it can justly be considered legitimized as a cooperative enterprise to the mutual benefit of its members. And it is the task of the legal order within which they are embedded to insure that the conditions for voluntariness of membership in private associations are indeed met.

The history of democratic polities can typically not meaningfully traced to some original social contract, yet, whether or not this is the case is of no immediate relevance for their current legitimacy. It is the *ongoing* voluntary agreement of its members-citizens that provides legitimacy to the constitution of a democratic polity, not some original agreement. A constitutional arrangement may have enjoyed voluntary agreement at its origin, but if it is no longer accepted by the citizens in its current effective form it can surely not be considered more legitimate than a constitutional arrangement that may have been imposed originally by outside force or by internal decree, but that in its current operation is met by general approval within the respective constituency. The essential burden of providing legitimacy to the operation of democratic polities lies with the *ongoing voluntary agreement* of their members-citizens to the respective constitutional framework.

autonomous private law subjects voluntarily form for their mutual advantage.²¹ Like the members of a private voluntary association the citizens of a democratic polity are the ultimate sovereigns in whose common interest the cooperative venture is supposed to work. And just as the members of a private cooperative venture face the problem of organizing their enterprise in ways that enhance the prospects for mutual advantage and limit the risk of measures being taken that are to their disadvantage, the citizens of a democratic polity face the problem of agreeing on a constitution that promotes the prospects for realizing mutual gains and reduces the risk of adverse policy measures. What, in particular, distinguishes the two cases is, as noted above, that private cooperative arrangements are formed under the umbrella of a private law system, enforced by the state, while democratic polities have to solve the problem of constitutional agreement in the absence of a comparable framework of rules that define and protect the rights of the participating individuals.

If democratic polities are to function as ‘cooperative ventures for mutual advantage’ they must be organized in ways that best insure responsiveness to their citizens’ *common interests* or, in other words, they must provide for *citizen sovereignty*. Actual and potential alternative institutional provisions can be compared in terms of their capacity to serve this purpose. Identifying the specific set of institutions that are best suited to assure responsiveness to citizens’ common interests or citizen sovereignty is the principal task of democratic constitutionalism.

The need to distinguish between the “true content of the democratic ideal” (Hayek 1979: 5) and “the particular institutions which have long been accepted as its embodiment” (ibid.: 1f) has been strongly emphasized by Hayek who takes care to make clear that his critique of the now prevailing form of democratic organization is not meant as a critique of the “basic principle of democracy” (ibid.: 4) but as a critique of what he considers a defective implementation of this principle. The target of his critique is not the basic democratic principle that all legitimate political power originates from ‘the people’ (Hayek 2001: 84), i.e. from the individual members-citizens of the polity, but an institutional form that he characterizes as *unlimited democracy*, as *unrestricted majority rule*.²² What he advocates is a *constitutionally limited democracy*, majority rule subject to constitutional constraints.²³

²¹ It is in this sense that Buchanan (1999b: 61) suggests a *politics-as-exchange paradigm* that looks at politics as “a structure of complex exchange among individuals.” As Buchanan (ibid.) notes: “Without some model of exchange, no coercion of the individual by the state is consistent with the individualistic value norm on which a liberal order is grounded.”

²² The view of that “popular sovereignty ... means ... that majority rule is unlimited and unlimitable” Hayek (1960: 106) criticizes as the “conception of the doctrinaire democrat.”

²³ Hayek (1960: 180): “A constitutional system ... means a limitation of the means available to a temporary majority for the achievement of particular objectives by general principles laid down by another majority for a

In their classic contribution to a constitutional liberalism, *The Calculus of Consent*, James Buchanan and Gordon Tullock (1962) have specified the prudential reasons why sovereign individuals in forming a polity – or, for that matter, any association for collective action – can be expected to adopt majority rule in deciding their ongoing common affairs. Hayek’s emphasis is on the fact that sovereign individuals are well advised to make such agreement contingent on majority rule being restricted by general principles. While insisting that liberalism is “incompatible with unlimited democracy” and “presupposes the limitation of powers ... of the majority by requiring a commitment to principles” (Hayek 1978b: 143), Hayek stresses that such limitation of majority rule is “not by another superior ‘will’ but by the consent of the people on which all power and the coherence of the state rest” (1979: 3). Constitutionalism, i.e. the principle “that all power rests on the understanding that it will be exercised according to commonly accepted principles” (Hayek 1960: 181), is in Hayek’s account in no way in conflict with the basic ideal of democracy but is a protective device that sovereign individuals have good reasons to adopt in organizing their political affairs. As he puts it: “Only a demagogue can represent as ‘antidemocratic’ the limitations which long-term decisions and the general principles held by the people impose upon the power of the temporary majorities. These limitations are conceived to protect the people against those to whom they must give power, and they are the only means by which the people can determine the general character of the order under which they will live” (ibid.).²⁴

A *constitutional liberalism*, a liberalism that views individual persons not only as sovereigns *within* the legal framework of the *private law society*, but no less so as sovereigns at the antecedent, *constitutional level* can, as Hayek’s arguments testify, be reconciled with an ideal of democracy that insists on the sovereignty of the members-citizens of a polity to jointly define the terms of their cooperative venture.²⁵ Just as voluntary agreement legitimizes

long period in advance.” – On the logic of constitutional constraints Hayek (ibid.: 179) comments: “The fundamental distinction between a constitution and ordinary laws is similar to that between laws in general and their application by the courts to a particular case: as in deciding concrete cases the judge is bound by general rules, so the legislature in making particular laws is bound by the more general principles of the constitution. The justification for these distinctions is also similar in both cases: as a judicial decision is regarded as just only if it is in conformity with a general law, so particular laws are regarded as just only if they conform to more general principles. And as we want to prevent the judge from infringing the law for some particular reason, so we also want to prevent the legislature from infringing certain general principles for the sake of temporary and immediate aims.”

²⁴ Hayek (1960: 182): “A commitment to long-term principles, in fact, gives the people more control over the general nature of the political order.”

²⁵ Mises (1949: 271) points to the symmetry between the issue of “the sovereignty of the individual” in the market and in the political arena when he notes: “It would be more correct to say that a democratic constitution is a scheme to assign to the citizen in the conduct of government the same supremacy the market economy gives them in their capacity as consumers.” – As Mises (ibid.) adds: “However, the comparison is imperfect. In the political democracy only the votes cast for the majority candidate or for the majority plan are effective in shaping the course of affairs. ... But on the market no vote is cast in vain.”

social transactions and corporate arrangements *within* the private law society, voluntary agreement among the parties involved must be considered the ultimate source of legitimacy of the legal-institutional framework within which individuals exercise their private autonomy. In this sense Hayek's (1960: 106) statement can be read that "it is the acceptance of such common principles that makes a collection of people a community. And this common acceptance is the indispensable condition for a free society."

5. The Protective State and the Productive State

The liberal ideal of individual liberty as private autonomy can be given substantive content only in the context of a framework of rules that define mutually compatible individual rights. The discussion so far has been mainly concerned with the fact that, where the framework of rules that constitute private autonomy is not self-evident and not self-enforcing, the private law society needs an agency, the state that codifies and enforces the rules.²⁶ It has been concerned with the implications of this fact for a liberalism that extends its basic normative principle, the principle of individual sovereignty, to the constitutional level. And it has pointed out the symmetry that exists between a constitutional liberalism that accounts for individual sovereignty in constitutional choice and the basic ideal of democracy as a cooperative venture of free and equal individuals for mutual advantage.

What individual liberty as private autonomy entails is, however, not only defined by what the private law system defines as individual rights. It is also limited by the *extent* of the 'assured private space,' i.e. by how the demarcation line between private law society and the state is drawn. The organization 'state' that the private law society needs to set up in order to enforce its 'rules of the game' can, once it exists, also be employed to carry out other projects that its members-citizens may consider of mutual advantage. Or, stated differently, the democratic polity as a citizen cooperative may advance the common interests of its members not only by the services it provides as enforcer and legislator of the rules of the private law society but also by providing other services of mutual interest. Buchanan (1975: 68f.) has coined the terms *protective state* and *productive state* to describe the difference between the two types of governmental functions. Hayek (1973: 48) speaks of "the distinction between the

²⁶ As M. Friedman (1962: 25) has put it, in order to peacefully live together in a free society we need a government as "a means whereby we can modify the rules, to mediate differences among us on the meaning of the rules, and to enforce compliance with the rules."

coercive function in which government enforces the rules of conduct, and its service function in which it need merely administer resources placed at its disposal.”²⁷

Recognizing the dual role of government as enforcing agent and as service agency raises the issue of what the ideal of liberalism implies for the permissible extent of the ‘productive state.’ Hayek expressly distances his own view from ‘minimal state’ conceptions that consider only legitimate the state’s role as enforcer of the private law system. Such conceptions, so he argues, “have nothing to do with the aim of securing individual liberty to all” (1979: 41), and he notes: “Far from advocating such a ‘minimal state’, we find it unquestionable that in an advanced society government ought to use its power of raising funds by taxation to provide a number of services which for various reasons cannot be provided, or cannot be provided adequately, by the market” (ibid.). The extent to which the members of a citizen cooperative decide to extend the state’s service functions is not an issue that can be decided a priori on liberal principles but is a matter of expediency that sovereign individuals have to decide among themselves in light of the expected benefits and the risks involved in extending the powers of government.²⁸ Liberal reasoning on the virtues of private enterprise and market competition can provide important arguments for citizens to consider in deciding on this matter, but they cannot deprive citizens from their sovereignty in choosing the arrangements under which they wish to live. While acknowledging that the principle of laissez faire rightly “expressed protest against abuses of governmental power,” Hayek (1973: 62) points out that it “never provided a criterion by which one could decide what were the proper functions of government.”²⁹ The liberal ideal of individual sovereignty can only provide a *procedural criterion* that indirectly judges the legitimacy of governmental arrangements by looking at the nature of the decision making process from which they result.

The distinction between the protective and the service function of government is related to, if not identical with, another distinction between two roles of government, namely the distinction between the state as the agency that defines and enforces the rules to which everybody within its territorial limits is subject, and the state as the cooperative enterprise that provides particular services to its members. In the first role the state can be characterized as

²⁷ See also Hayek’s (1960: 222) comments on the “distinction between the coercive measures of government and those pure service activities where coercion does not enter or does so only because of the need of financing them by taxation.”

²⁸ As Hayek (1979: 45) explains, citizens’ choice to allow government to take on such service functions can be looked at “as a sort of exchange: each agreeing to contribute to a common pool according to some uniform principles. ... So long as each may expect to get from this common pool services which are worth more to him than what he is made to contribute, it will be in his interest to submit to coercion.” - The notion that politics in a free society may be conceptualized as exchange is central to Buchanan’s contractarian constitutionalist approach (see fn. 20 above).

²⁹ Hayek (1973: 62) adds: “Much the same applies to the terms ‘free enterprise’ or ‘market economy’ which, without a definition of the free sphere of the individual, say little.”

territorial enterprise, in the second as *community enterprise* of its citizens. In both roles the democratic state acts as the agent of its citizens and its activities have to be legitimized in terms of the common interests of its members-citizens. Yet there is a critical difference between the two. In its first capacity the state codifies and enforces the rules of the private law society and its twin, the market economy, rules that apply equally to its citizens as private law subjects as well as to non-citizens who, as private law subjects, reside or operate within the state's jurisdiction. By contrast, in its second role the state legislates and enforces the rules that constitute the polity as a corporate organization, rules that define the terms of membership in the polity and that, accordingly, apply to individuals only in their capacity as members of the polity. The noted difference is of importance because the rights and obligations that exist between individuals as private law subjects, i.e. as members of the private law society, and the rights and obligations that define their status as members of the polity are categorically different. And it is, as I suppose, the failure adequately to keep the two functions apart that is behind many of the problems of the modern democratic welfare state that have been the particular target of liberal criticism.

The rules that constitute the private law society and the market economy define an open arena for voluntary cooperation between individuals who are obliged to respect the general 'rules of the game' but, otherwise, have no obligations to each other except for those that they voluntarily enter into by mutual contract. In terms of Hayek's (1973: 35ff.) distinction between 'two kinds of order': the private law society is a *spontaneous order*, not an *organization* in which individuals cooperate as a team in order to produce 'collective goods.' Within the private law society autonomous private law subjects can create organizations by voluntary contract, but the private law society itself is not a joint enterprise to which its members owe certain contributions and from which they receive benefits in return. It is an 'open society' in which everybody can participate who respects its rules, not a 'club' with membership dues and membership rights. By contrast, the state as *community enterprise* is an organization, an organization that, notwithstanding its specific nature, can indeed be compared to a club whose members, the citizens, are obliged to pay their membership dues and are entitled to club-services, as these obligations and entitlements are defined by the constituting rules of the organization.

The distinction between the state as *territorial enterprise* that provides the institutional framework for the private law society and the state as *community enterprise* of its citizens is of particular significance in regard to the role of 'social legislation,' i.e. in regard to the ways in which the state can provide a 'social safety net' for its citizens. Hayek has addressed the

issue that is at stake here in his discussion on minimum income provisions. His principal argument is clearly stated in a paragraph that is worth quoting at length:

“There is no reason why in a free society government should not assure to all protection against severe deprivation in the form of an assured minimum income, or a floor below which nobody need to descend. To enter into such an insurance against extreme misfortune may well be in the interest of all; or it may be felt as a clear moral duty of all to assist, within the organized community, those who cannot help themselves. So long as such a uniform minimum income is provided outside the market to all those who, for any reason, are unable to earn in the market an adequate maintenance, this need not lead to a restriction of freedom, or a conflict with the Rule of Law” (Hayek 1976: 87).

By speaking of “the organized community” as the provider of minimum income insurance, and by noting that, as long as such insurance is provided “outside the market,” a “conflict with the Rule of Law” does not arise, Hayek implicitly draws the same distinction between the two state functions as that discussed above.³⁰ As members of “the organized community” citizens can, through the political process, enter into all kinds of commitments, including commitments to assure each other a minimum income in case of need. In deciding on its size and the terms under which it is provided they will have to consider, as a matter of prudence, the incentive effects of such schemes, the risks of abuse, and other problems that they may involve. There is no objection, though, that could, in principle, be raised where such insurance arrangements are chosen by citizens who exercise their sovereignty in defining the terms under which they wish to live together. A minimum income insurance provided by the state as *community enterprise*, and financed by the contributions citizens are willing to make for this purpose, is, however, entirely different from the state intervening in the market by ‘social legislation’ that is in conflict with the nature of the market as the “game of catallaxy” (Hayek 1976: 115ff.). Such ‘social legislation’ obfuscates – and this is Hayek’s essential point – the categorical difference between the private law society and the polity as a corporate organization, and the categorical difference between the universal rules of conduct that define the arena within which autonomous private law subjects meet, and the rules of organization that define the rights and obligations of citizens as members of a the state as community enterprise. This is meant when Hayek (1973: 141) speaks of the “transformation of private law into public law by ‘social legislation’.”

³⁰ The proviso “outside the market” is expressly emphasized by Hayek at several places where he addresses the issue of a minimum income insurance. See e.g. Hayek (1967a: 175): “There is of course no reason why a society which, thanks to the market, is as rich as modern society should not provide *outside the market* a minimum security for all who in the market fall below a certain standard. Our point was merely that considerations of justice provide no justification for ‘correcting’ the results of the market and that justice, in the sense of treatment under the same rules, requires that each takes what a market provides in which every participant behaves fairly” (emphasis in the original). See also Hayek (1979: 142).

The fact that, in his view, it tended to erode the critical distinction between the function of the state as community enterprise of its citizens and its role as guardian of the private law society was the essential reason for Hayek's (1967b: 244) reservations about the German concept of the 'Soziale Marktwirtschaft' (social market economy). And, just as the development that the 'German model' has taken over the decades of its existence testifies indeed to the justification of Hayek's concerns, the failure to adequately separate between the two functions of the state must, in general, be counted among the root causes of many of the problems of the modern welfare state.

6. Individual Liberty and Citizen Sovereignty in the European Union

In both its functions, as territorial enterprise that, within its territorial boundaries, defines and enforces the rules to which individuals – citizens as well as non-citizens – are subject in their private activities and as a community enterprise, the democratic state is an agency that is supposed to serve the common interests of its principals, the members of the polity. In the discussion so far the 'polity' has implicitly been identified with the nation state. Yet, individuals are organized, of course, in political units at various levels and with different territorial extensions such as local communities, states or provinces, nation states, and supra-national units such as the European Union. Such multi-level political organization can account for the fact that the interests that people have in common may very well vary across territorial units, both with regard to the general rules of conduct to which they are willing to submit as well as with regard to the services that they wish to see provided by their respective community enterprise. The ideal that democratic polities function as cooperative ventures for mutual advantage requires that the exercise of political authority with regard to both governmental functions matches the geography of citizens' common interests.

In this concluding section I want to take a brief look at the role the European Union can play as a supranational political unit in regard to the two noted governmental functions, as a *territorial enterprise* that legislates and enforces rules that define and protect the rights of individuals as private law subjects within its inclusive jurisdiction, and as a *community enterprise* that provides services funded from a common pool which the citizens of the member states have to finance by their contributions.

The most important, and unambiguously positive contribution that the process of European integration has made to advance individual liberty and citizen sovereignty is in creating a common market with its '*four freedoms*,' the freedom of movement of goods, persons, services and capital. This has significantly enlarged the liberty of individuals as

private law subjects to engage in voluntary trade and cooperation with other private law subjects across the European Union, uninhibited by the obstacles that national boundaries between the member states would otherwise tend to present. And, by facilitating the exit-option, it has increased inter-jurisdictional competition between the member states, making governments more responsive to the interests of their citizens and to the interests of those whose business they wish to attract to their jurisdiction.

Considering the heterogeneity of interests that must be presumed to exist between the different people across the various member states, the prospects for the EU to serve, as *community enterprise*, common interests of all European citizens are surely much more limited. Whatever genuinely common interests one may be able to identify that citizens across all member states share with regard to community services they are willing to finance from a common pool, interests in redistributive arrangements are particularly unlikely candidates. In an article on “The Economic Conditions of Interstate Federalism,” originally published in 1939, Hayek (1948) predicted that, because the feelings of solidarity and “the sympathies with the neighbor” (ibid.: 263) as well as the “homogeneity and the similarity in outlook and tradition” (ibid.: 264) that may facilitate agreement on redistributive social insurance arrangements within nation states are absent in a federation “composed of people of different nationalities and different traditions” (ibid.), the scope for such policies would be much narrower for the central government than for national government, and he expected the danger of such policies to become the playing field of special-interest lobbying and rent-seeking to be much more limited in a federation than in a nation state.

The role that redistributive policies have come to occupy in the European Union indicates that Hayek’s expectations about the functioning of interstate federalism may have been overoptimistic.³¹ In fact, it is in this regard that European integration started with a ‘birth defect’ by including the redistributive common agricultural policy in its founding document, the Treaty of Rome. This provided the model that allowed further redistributive elements – such as structural funds, cohesion funds or the social charter – to be included into the Union’s policy agenda. It is these areas of EU policies for which it is most doubtful whether they can be legitimized in terms of genuine common interests that citizens across the various member states share. If the EU is to function as a guardian of individual liberty and citizen sovereignty it is clearly its role as territorial enterprise that ought to be strengthened while its authority as community enterprise ought to be strictly limited.

³¹ M. Wohlgemuth (2008) critically discusses Hayek’s argument in the context of a review of “50 Years of European ‘Ordnungspolitik’.”

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