

## **Elster for Economists**

Salomon Kalmanovitz

In the highly specialized and formalized world of economics, it is refreshing to come across the ample and multi-disciplinary work of Jon Elster. Among the many reasons why this is so, I am only going to deal with three on this occasion. He reminds us, first, that the social sciences, including economics, should not only take the rational individual into account but also the passions and impulses that lead him into directions that are hard to predict. Second, that inherited and petrified social norms restrict and guide his conduct, which means that Elster is close to the Neo-institutionalists<sup>1</sup> in considering that norms are issued by formal and informal institutions. And, third, that politics and constitutional regulations play an important role in economic development. Finally, I would like to deal with the independence of the central bank, as a limitation of the executive government's power to abuse monetary emission. I would like to clarify the fact that I only have a partial knowledge of Elster's work and that the following remarks reflect my own reactions - and those of my colleagues as well, I assume - to some of his free-wheeling positions.

What is interesting about Elster is that his mathematical training gives him the capacity to formalize, through game theory and modal logic, many situations in which individuals are forced to react, as well as the ability to discern when formalization advances or does not advance our knowledge of society. We perceive this attitude in his remarks about the strengths of neo-classical economics:

Whatever objections one may have to neo-classical economics, it certainly is something: a highly developed and formalized body of thought which has been applied to a wide range of practical and theoretical issues. One would hesitate before saying that the work of Marx, Schumpeter or Herbert Simon was 'nothing', and the 'sophisticated practitioners' referred to above would certainly not make any such judgment. Yet they would tend to say that their writing, though not lacking in insights, is amorphous, their ideas unformalised and unformalisable. (Elster, 1983, 5).

In Latin-American academic circles, where a social progressivism predominates, methodological individualism is seen as an anathema and inherently reactionary. Elster takes it for what it is and determines the extent to which it may adequately replicate human conduct.

This issue is related to the conflict over methodological individualism, rejected by many Marxists who wrongly link it with individualism in the ethical or political sense. By methodological individualism I mean the doctrine that all social phenomena (their structure and their change) are in principle explicable only in terms of individuals - their properties, goals, and beliefs. This doctrine is not incompatible with any of the following true statements. (a) Individuals often have goals that involve the welfare of other individuals. (b) They often have beliefs about supra-individual entities that are not reducible to beliefs about individuals. "The capitalists fear the working class" cannot be reduced to the feelings of capitalists concerning individual workers. By contrast, "The

---

<sup>1</sup> I refer to the work of Douglass North, Ronald Coase, Oliver Williamson, among many others.

capitalists' profit is threatened by the working class" can be reduced to a complex statement about the consequences of the actions taken by individual workers.<sup>1</sup> (c) Many properties of individuals, such as "powerful," are irreducibly relational, so that accurate description of one individual may require reference to other individuals. (Elster, 453, 1982).

The opposite of methodological individualism would be methodological collectivism, or the holism that explains human behavior in terms of social aggregates. The two approaches are not incompatible, since they may and should be combined: each reflects different aspects of social realities. While individuals make decisions that relate to their preferences and knowledge, they cannot be sovereign insofar as they cannot escape from the social norms that surround them, which are slowly built up throughout history. The collectivists would thus soften individual responsibility in their analyses of ethical matters and those concerning law and punishment.

Together with John Roemer, Elster was an exponent of the so-called "Analytical Marxism" in the 1980s and has published a great deal about that school. He has closely examined and carefully analyzed every one of the tenets of Marx, not only the economic but the philosophical and political ones as well. He finds much richness in the historical logic developed by Marx, but questions his way of thinking in parts of his work which suffer, he believes, from the primitive functionalism of the social sciences - what he calls the "functionalist fallacy", the idea that there are dark (or bright) forces behind all of the phenomena that sinisterly (or miraculously) regulate life.

In the view of some trends of Marxism, including Marx himself sometimes, the bourgeoisie itself engineers everything that benefits the bourgeoisie, although how this happens is not explained. Marx's teleological sense of history, in turn, predetermines historical trends and morally identifies its agents. The possibility that events are disconnected from one another - that they are the disorderly and meaningless expression of clashing interests -- is not accepted. Above all, the analysts who find sinister influences in social structures do not concern themselves with determining the mechanisms of transmission between events and their consequences. There are ends, but no agents that bring them about.

In the case of the more radical theories, Elster himself refers to the functionalist approach, in opposition to the vision of history as a process in which Marx . . . notes the existence of "what Sartre calls 'counterfinality' - the systematic production of consequences that are harmful, unintended, and unrecognized". But, on other occasions, Marx abandons this vision in favor of the functionalist paradigm, as when he asserts, in the theories of surplus value, that, "1 . . . the various functions in bourgeois society mutually presuppose each other;  
2 . . . the contradictions in material production make necessary a superstructure of ideological strata, whose activity - whether good or bad - is good, because it is necessary;  
3 . . . all functions are in the service of the capitalist, and work out to his "benefit"; " (Elster, 1982, 456) that is, that all activities benefit the capitalist class and these benefits explain its existence. "This conspiratorial world view, in which all apparently innocent activities, from Sunday picnics to health care for the elderly, are explained through their function for capitalism, is not, however, pervasive in Marx's work." (Elster, 1982, 456).

The functionalist fallacy haunts much of the work done in the social sciences in radical circles, including some of the Right. Elster explains it with such thoroughness and care that I hope his work will help investigators to keep their guard up when tempted into the accusatory stance that relates to functional or conspiratorial explanations.

### **The rational individual**

The neo-classical economists posit the existence of a rational individual who maximizes his utility in the face of a range of clearly perceived choices, or in other words, with suitable and free information. In fact, many decisions made by such agents are rational, but, according to Elster, others touch the realm of the irrational, for which reason they cannot be anticipated or calculated in an adequate way. There also arise situations in which the agent may descend from complete rationality to imperfect rationality and from there to problematical rationality and finally, to complete irrationality.

Nevertheless, these agents may recur to certain strategies to avoid being victims of their irrational decisions, which is done through precommitments. A good example would be the way that Ulysses lashed himself to the mast and put wax in the ears of his crew to avoid the lure of the Sirens' songs. Or the constitutional rights given to minorities which majorities are bound by (Elster, 1989).

In *Sour grapes* Elster (1983) analyzes the capacity for self-deceit, which the agents have by citing the fable in which the fox, being unable to reach the grapes, says that they are worthless. Such attitudes undermine "the principle of rational choice which declares that the beliefs of individuals are completely independent of objective parameters". (Pedraza)

The opposite occurs when preferences succumb to the temptation to appropriate the belongings of others: the belief that the grass is greener on the other side of the fence or that my neighbor's wife is more desirable than my own. Only individuals gifted with responsibility may correctly understand their preferences and thus avoid falling into the trap of the narcissistic ego, Elster states, which does not mean, however, that he believes in psychoanalysis.

In *The Cement of Society*, Elster draws a distinction between individualism and holism:

One of the most persistent cleavages in social sciences is the opposition between *homo economicus* and *homo sociologicus*... The former is supposed to be guided by instrumental rationality, while the behavior of the latter is dictated by social norms. The former is pulled by the prospect of future rewards, whereas the latter is pushed from behind by quasi-inertial forces. The former adapts to changing circumstances, always on the lookout for improvements. The latter is insensitive, sticking to the prescribed behaviour, even if new and apparently better options become available. The former is easily caricaturized as a self-contained, asocial atom, and the latter as the mindless plaything of social forces or the passive executor of inherited standards. (Elster, 1989, p. 97).

In this respect, Rutherford, an author who has written about the history of institutionalist ideas, observes that if acculturation conditions the restrictions and preferences of the

individual, then economists may not ignore the serious doubts about their work that arise from social norms and how they relate to one another in the exercise of rational and evaluative processes. In fact, institutions, in the language of North, issue norms and they may take the form of rigid impositions or voluntarily assumed rules of conduct.

The norms are reinforced because others control individuals in order to make them comply with the norms and they feel bad when they fail to comply with them. The line of thought developed by the psychologist William James holds that the individual tends to develop habits and routines, linked to social norms, which exempt him from deciding what course of action to take in situations of uncertainty, decisions which in themselves are exhausting for the human brain. It is a way of saving neurons (Rutherford, 55).

Elster accuses those who insist that every action may be explained in terms of rationalism as being “hyper-rational”. They are unable to recognize the limitations and borders of rationality, maintaining an “irrational belief in the omnipotence of reason”. (Rutherford, 79). In fact, rational conduct is not a constant in the conduct of humans, who are victims both of their own emotions and passions, and the regulations that arise from their social setting.

In the same *Cement*, the author defines the social order in two ways: as regular and predictable conducts and as cooperative conducts. In a corresponding way, disorder appears as the impossibility of predicting conduct, as Macbeth said of life, “it is a tale told by an idiot, full of sound and fury, signifying nothing”, or, in the manner of Hobbes, as non-cooperative conduct, in which men face each other like wolves and lead a life that is “solitary, poor, nasty, brutish and short”. “Instead of referring to predictability and cooperation, economists talk about equilibrium and Pareto optimality” (Elster, 1989, p. 1), which distances them from the multiple conducts that simply cannot be explained on the basis of the suppositions of rationality and the maximization of utility.

Another problem which Elster confronts is the extent to which the theory of rational choice is valid. As soon as you take into account conducts of imperfect rationality, the existence of uncertainty, the cost of information and the presence of social norms that may or may not have a rational aim, the theory begins to break down. One example would be a mushroom gatherer who has only managed to explore part of the forest and does not know whether to continue to collect them in the area he already knows or to keep on searching until he finds places where the mushrooms are more abundant. Given that his time is limited to the period of daylight, the decision he makes ignores the terms of the choice. Thus, the options which are available to the individual are limited by the cost and imperfect nature of the information, and thus by his inability to weigh the alternatives and correctly choose the ones that bring the optimum results.

Despite the truth of this situation, it does not imply an anarchic universe, devoid of all order, given that the individual may be well or poorly informed and the norms emitted by institutions may be sufficiently adequate – it will also depend on the quality of the existing institutional framework –, and on the basis of that information and their routines individuals may make reasonable decisions. In short, the individual may make relatively good decisions and the scope of neo-classical theory should limit itself to that.

If we combine Elster's idea with those of neo-institutional economics, this implies that in systems which have institutions and norms that encourage irrationality, most individuals will make bad decisions, ones that fail in the maximization of utility or wealth.

### **The role played by social norms**

We economists tend to ignore both the behavior caused by social norms and that which arises from the emotions of the agents themselves. Throughout his work Elster deals with and advances our knowledge of both of these factors. He begins by offering a simple definition of what a social norm is or is not. "I define social norms by the fact that they are not outcome oriented. The simplest social norms are of the type: Do X or Do not do X. More complex norms say, If you do Y, do X, or if others do Y, do X". (Elster, 1989B, 98) At the same time, norms are overseen by others and are not always based on individual interest.

Elster adds that "to accept social norms as a driving mechanism does not violate methodological individualism. Social norms, as I understand them, are the emotional and behavioral propensities of individuals"... "A norm, in such perspective, *is the propensity to feel shame and to anticipate sanctions by others at the thought of behaving in a certain, forbidden way*" (Elster, 1989B, 105)

Norms are upheld because their transgression produces intense feelings both in the offender and in others, who openly or secretly condemn deviant conducts. Norms do not require external sanctions to be effective. When they are internalized they are still maintained, even if their violation goes unnoticed or does not lead to punishment. Shame or the expectation of it is a sufficient internal sanction and can prevent individuals from committing censurable actions. Or guilt, which is even more effective, because it punishes the person who fails to carry out his duty with a profound unease about himself.

When those who believe in rational choice hold that the extent of crime exclusively depends on its profitability, they are ignoring the role played by social norms, many of them internalized, which might reduce or increase crime by its limiting action on the individual, from which we may conclude that there is more to crime than a simple valuation of its profitability.

Norms are interpreted in accordance with the interests of the agents. In this way, "In wage negotiations, sheer bargaining power counts for much. Appeals to accepted social norms can also have some efficacy, however. There is a norm of fair division of the surplus between capital and labor. Employers will appeal to this norm when the firm does badly, workers when it does well. There is a norm of equal pay for equal work. Workers will appeal to this norm when they earn less than workers in similar firms, but not when they earn more. (Elster, 1989, 102) .

Elster writes that "Gary Becker (of the Chicago school of economics) argues, for example, that the "combined assumptions of maximizing behavior, market equilibrium and stable preferences, used relentlessly and unflinchingly... provides a valuable unified framework for understanding *all* human behavior." This view suggests that norms exist because they promote self-interest, over and above the avoidance of sanctions". (Elster,

1989, 105). However, it is evident that some social norms worsen the situation of all the agents, like the vendetta in southern Italy (2 eyes for an eye), codes of honor, the rejection of homosexuals, the norms implemented by religious authorities, etc.

Elster offers three arguments against the idea that norms are rational and, reiterating his criticism of functionalism, that their consequences explain their existence:

First, not all norms are Pareto-improvements. Some norms make everybody *worse* off, or, at the very least, they do not make almost everybody better off. Secondly, some norms that would make everybody better off are not in fact observed. Thirdly, even if a norm does make everybody better off, this does not explain why it exists, unless we are also shown the feedback mechanism that specifies how the good consequences of the norm contribute to its maintenance.(Elster, 1989B, 108)

Consider the social norms against behavior "contrary to nature." Some of these norms like those against cannibalism and incest, are good candidates for collectively beneficial norms. Everybody benefits from a norm that forces people to look elsewhere than to other people for food.<sup>6</sup> Norms against incest may well be optimal from a number of perspectives: individual, collective or genetic. Norms against sodomy, by contrast, involve only harmful restrictions of freedom and no benefits. They make everybody worse off. Norms against homosexuality might also, under conditions of overpopulation, make everybody worse off (Elster, 1989,109).

And he continues:

I believe that both norms and self-interest enter into the proximate explanations of action. To some extent, the selection of the norm to which one subscribes can also be explained by self-interest. Even if the belief in the norm is sincere, the choice of one norm among the many that could be relevant may be an unconscious act dictated by self-interest or one might follow the norm out of fear of the sanctions that would be triggered by violation. But I do not believe that self-interest provides the full explanation for adherence to norms. There must be some further explanation, *X*, of why norms exist.... I suggest, however, that a good research strategy might be to investigate the role of emotions in maintaining social norms. Also, the often-ignored phenomena of envy and honor might repay further study. Finally, the psychological theories of conformism should be brought to bear on the subject. (Elster, 1989, 115)

### **Constitutions and economic performance**

One of the subjects that interests Elster are constitutions and it is worth mentioning his membership in a team of social scientists who reflected on the drafting of new constitutions by the countries of Eastern Europe after the collapse of socialism. An essay written by Elster in 1994 is entitled, "The impact of constitutions on economic performance", which I will now synthesize and analyze, placing emphasis on the way that constitutions influence economic development, insofar as they promote the values of stability, accountability and credibility. Accordingly, constitutions partly serve as the

“flywheel” of a machine, which keeps it in continuous operation without losing its rhythm. In another sense, they partly serve as a “feedback mechanism” and as a “precommitment device”. (Elster, 1994, 3)

In the structure of modern constitutions Elster finds that not only the written statutes are important but also what he calls the “constitutional conventions”. As an example he cites the independence of the U.S. Federal Reserve Board, which is not explicitly written into the Constitution, as it is in countries like our own. “Yet de facto the Board enjoys considerable autonomy because of an unwritten constitutional convention by virtue of which any attempt by the executive or the legislature to interfere with its activities would incur costly political sanctions”.<sup>2</sup> (Elster, 1994, 3)

Constitutions may be efficient or inefficient. Elster cites the case of the constitutions of the socialist countries, which were rhetorical and difficult to apply to their institutional or juridical arrangements. There was a proliferation of economic and social rights (the right to employment, leisure, housing) that were systematically mocked by the system. Constitutions which are too extensive try to freeze the agreements of their signatories in time, preventing future generations from deciding about such matters.<sup>3</sup>

Constitutional provisions that deal with the workings of government may be simple and not require a special interpretation, but those, which deal with basic rights, must always be made explicit or reinterpreted by judicial decisions.<sup>4</sup> The design of the division of powers and checks among the different branches of power is important. There are countries in which there is no effective judicial control over the legislature and others, like the United States, in which it is pretty strong.

In two-chamber systems the senate controls the lower house: each has a different source of representation or simply replicates it.<sup>5</sup> Single house systems, like those of Venezuela and Ecuador, may be a threat to democracy, because all power is concentrated in their hands in times of crisis: in the case of Ecuador the Congress has recently deposed two presidents.

The constitution always tries to specify the rule of law: thus, it prohibits retroactive laws or taxes; guarantees compensation in the case of expropriations of property; requires search warrants for the police to enter homes in search of information or to apprehend criminals; and provides the right to a fair trial.

---

<sup>2</sup> In Colombia, the Constitutional Court has, on repeated occasions, managed to subject the central bank to its will, without suffering any criticism. On the contrary, its interference has been strongly supported by the Congress and the mass of debtors, despite the fact that the bank’s independence is enshrined in the Constitution.

<sup>3</sup> When even the percentages of gross national revenues that are destined for the regions was written into the Colombian constitution, that it might jeopardize the solvency of the central government was not considered. Thus, a matter which should be revised with a certain frequency was removed from the realm of politics.

<sup>4</sup> This is also notable when there are constitutional courts that recur to juridical activism and are continually recreating the constitution. Elster cites the case of Hungary, but Colombia is another obvious example.

<sup>5</sup> This is the case of Colombia once again, cfr. (Rodríguez, 2001).

The constitution may lack credibility and acceptance among an important part of society if it is not accepted by a consensus that is not only electoral but involves the economic sectors as well. One of the reasons why Venezuela was unstable in 2002 had to do with the fact that its constituent assembly, which was overwhelmingly dominated by Colonel Chavez, was never accepted by the entities responsible for production, including the big trade unions. By contrast, the Colombian Constitution of 1991 was not approved by such a large vote but it was passed within a consensus of the country's economic and social forces, which has given Colombia a large measure of political and economic stability.

The U.S. Constitution implicitly guarantees the right to the *pursuit* of happiness, which is one of the "unalienable rights" of people enumerated in the Declaration of Independence, along with "life" and "liberty." Because the right is not set forth in the U. S. Constitution, it is not enforceable by the courts. However, the right to the pursuit of happiness is often raised in arguments against government regulations, because its mention in the Declaration of Independence and several State Constitutions gives it a degree of forcefulness. But "there is no constitution that guarantees the right to happiness itself, although there are, among them, ones which guarantee all the things that tend to promote happiness, like the right to employment, unemployment benefits, a decent pension, health, decent housing . . . etc." Whether social rights become a dead letter or turn into social realities depends on political will, the availability of economic resources and the constitutional doctrines developed by the courts. A Religious state, on the other hand, would possess an exact knowledge of what constitutes the eternal happiness to which all citizens should aspire.<sup>6</sup>

Constitutions are characterized by the components we have mentioned: rights and the workings of government. They are considered to be so basic that they should not be subject to easy change, that is, by ordinary legislative procedures: such changes must require more demanding or complex mechanisms. Such mechanisms include approval by large majorities, waiting periods, approval by several successive legislatures, confirmation by the courts, referendums and, in the case of federal governments, approval by all of their regional legislatures.

Social organization may be judged in terms of two counterpoised criteria: promoting the utility of all citizens or national wealth, or, alternatively, guaranteeing a higher level of well-being for the poorest sectors of the population, as John Rawls advocates. Elster believes that the former responds to a criterion of *efficiency* and the latter to one of *security*. Although the two criteria should complement each other, this is not necessarily the case, given that the latter implies a transfer of revenues that, while it guarantees security, undermines efficiency, insofar as it leads to problems of incentives. There is also the danger that some of the transferred revenue may wind up in the hands of opportunists or that the reform may require a costly bureaucracy to administer it.

---

<sup>6</sup> The case of Colombia is unusual, in that the right to "decent housing", as a factor that creates happiness, is guaranteed by the constitution, thus allowing a non-representative power (the judiciary) to commit public resources in the face of other goals, with a higher priority and a greater impact on development or social welfare, that might be chosen by a representative body or the executive, which might devote those resources to improving the nutrition of children or providing medical care for pregnant women.



In any case, the two criteria tend to be mutually exclusive in some cases and convergent in others. The free hiring of workers subverts security and improves efficiency. Although it is not possible to measure the net effect of the two criteria, a society that advances on the basis of efficiency will tend to increase security insofar as efficiency guarantees abundant economic resources for the transference, as is seen in the economies of Southeast Asia.

This is an important lesson for Colombian economists, because we tend to polarize around the extremes of this duality: an “efficiencyism” that judges all policies in terms of increases of wealth or a “guarantism” that prefers to destroy all possibility of economic growth when it implies compromising their ideals.

With regard to political and civil rights, Elster reminds us of Amartya Sen’s argument that there have been no famines in countries which have democratic forms of government and a free press.<sup>7</sup> (Sen, 1999, p. 32). This is because the press informs the public about the conditions that may lead to a disaster and politicians are forced to take measures to prevent or alleviate it. However, Elster says that this argument is weakened by the case of the United States, where there is no comprehensive health insurance and the level of health is lower than that of some developing countries: this happens because the poorer sectors of the population do not vote, so that the politicians who reject a comprehensive health legislation are reelected by the middle class, which does receive benefits. The fact is that the poor do not exercise their political rights, which has to do with their economic situation, a circumstance to which Rawls also refers. In India as well, some of its states have suffered from famines, in spite of democratic forms of government.

The mere existence of social rights does not mean that they will be put into practice. The rights to employment, job security, a minimum wage, or a free service of health or education do not guarantee economic security. The reason for it is that they tend to be impossible to put into practice or if they are, they become self-defeating. A country may be too poor or have too low a tax base to implement them. Elster gives the example of the right to full employment in the socialist countries, which were so inefficient that wages there were lower than the unemployment benefits enjoyed by the workers of Western Europe. In Colombia, the law which obliged employers to offer permanent employment to workers with more than 10 years of experience meant that the bosses would fire them before they reached that date, while a minimum wage set systematically above the inflation rate tends to increase unemployment or lead to wage agreements between employers and workers that are below the minimum in the informal sector, which employs a bigger work force than the formal one. If unemployment insurance is financed through payroll taxes, bosses will offer fewer jobs and seek to increase the efficiency of the workers they already employ. If it is financed through a general tax, it will not have these harmful secondary effects. Free education financed through local or national taxes avoids these kinds of self-destructive consequences.

The social rights which have positive consequences for efficiency are not so apparent, but they are important. Public education and health services help to build a stronger

---

<sup>7</sup> This was recently seen in the growing famine in North Korea, where the government took a long time to swallow its national pride and ask for international aid.

workforce. Since such policies take a long time to show results, it is advisable to give them a constitutional priority, so that they will not be relegated to a minor position compared to policies which offer more immediate results but may have a lesser long-term impact. Unemployment insurance, for example, prevents the destruction of a trained and experienced workforce. (Elster, 1994).

Political and civil rights arose in circumstances in which the political agents were committed to following a given course of action. Their credibility depended on complying with such commitments: renouncing them became too costly. It is possible to make the commitments written into a constitution credible if power is divided among an executive branch, an independent judiciary and a democratically-elected legislature. Elster cites the classic essay by North and Weingast about the credibility of constitutional commitments before and after England's Glorious Revolution. The constitutional monarchy which had been established could not ignore parliament, as it had done in the past, because parliament had the military capacity to overthrow and decapitate kings, which ensured that the sovereign would obey the decisions of the legislature. The sovereign no longer governed by divine right but by the will of the people, which was represented in the parliament.

In addition, parliament itself accepted self-imposed restrictions on its power: "in large measure, the creation of an independent judiciary expanded the government's capacity to honor its agreement, that is, to limit its power". (North and Weingast, 199). If officials did not carry out such agreements, the weight of the law would fall upon them. At the same time, by allowing the monarch and the House of Lords to survive (the latter as a sort of supreme court of justice), parliament once more acknowledged that its power would be limited by other bodies and that it would not abuse it. The principle of taxation with representation allowed for a considerable increase of taxation, insofar as taxpayers became able to oversee the spending of public funds and the state became an efficient businesslike organization. There thus arose a number of factors which joined in a virtuous circle: a financially strong state, efficient public spending that accelerated the private accumulation of capital and additional government financing through public debt that encouraged a financial revolution and, at the same time, established the foundations of a deep capital market.

Precommitments need democracy in order to be credible and effective, although some dictatorships, like that of Pinochet, offered guarantees and self-limitations which had no way of being institutionalized. That dictatorship ran into the problem of the successor government, which could not be chosen by methods other than democratic ones; on the basis of its own excessive power, it could not offer credible or universal guarantees.<sup>8</sup> The countries of East Asia count upon advisory councils made up of business leaders, which act as checks on the power of governments – still pretty despotic, to be sure – and guarantee that the government will not expropriate the property of investors. In those countries, moderate taxes and a strong economic growth have financed an equitable judicial system and the universal distribution of social benefits like education and health, ensuring the stability of their governments. But we should remember that if there are no effective checks on government power, it may act arbitrarily, not only against the

---

<sup>8</sup> It is worth noting the paradoxical fact that the kind of succession that took place in absolutist monarchies – that is, one governed by family ties or simple heredity – has been a characteristic of socialist countries like Albania and North Korea and may occur in Cuba

opposition, but its capitalists as well. If it is strong enough to defend property rights, it will also have the strength to expropriate property.

Another advantage of democracy is that it makes it possible to correct errors in public policies through elections or market forces, an argument that Elster advances. Political freedom means that society will not always have to suffer the effects of inefficient bureaucratic policies or inept leaders. “The removal of bad leaders, or a movement towards efficient allocation has the same result - better economic performance”.(Elster 1994, 16)

To illustrate the above affirmation it is worth noting that nothing happened to Fidel Castro in 1970, when he not only dramatically failed to reach the goal of a 10 million ton sugar harvest, but also mispent other resources of the country, causing an additional loss of GDP of around 15%. He spoke to the masses for many hours and they “forgave” him. There are many cases in which the electorate voted for security and rejected efficiency, as can be seen in the Peruvian elections of 2001, when Alan García obtained 40% of the votes, despite the fact that he had led Peru to a 7,000% inflation rate and reduced its GDP by a third, a decade before. We tend to forget that the average voter has a poor memory.

In any case, both rich and poor countries face the dilemma of dealing with voters who act in a short-sighted way when they favor enormous transferences which the rich will regard as confiscatory. In the debates that surrounded the establishment of universal suffrage, there were warnings that an excessive emphasis on security, as opposed to efficiency, would arise when all sectors of the population obtained the right to vote. But this did not occur, in fact, because the workers acted in a sensible rather than a shortsighted way, making sure that their demands for strong social benefits did not kill the goose that laid the golden eggs. In the United States, the rich imposed the constitution, which was sufficient to prevent any confiscatory demands. Nevertheless, as North notes, the losers were able, up to a point, to recur to the political system and the courts to compensate for their losses. In the opinion of Elster, the emergence of the welfare state had more to do with the trade unions movement than universal suffrage.

### **The independence of the central bank**

Elster analyzes the central bank in a section entitled “Omnipotence, strategic conduct and the separation of powers”, which is based on the idea that, paradoxically, power must be divided in order to be effective and that, instead of being a blessing, omnipotence may turn out to be the opposite for a ruler. “You cannot support yourself on that which resists you”, was the phrase Tocqueville used to explain the fall of *L'Ancien Régime* in France. “Having reduced the nobility and bourgeoisie to a state of impotence, the monarchy found itself without allies to support it when it was attacked”. (Elster, 2000, 146-147). The sovereign who infringes the rights of the majority of his subjects and does not at least use the strategy of dividing to rule will acquire so many enemies that they will eventually wrest his power from him.

One reason not to antagonize the creditors of the Treasury was to establish The Bank of England as a private company from which the government was excluded for two reasons. In the first place, the interests of the bankers and creditors of the government were represented in parliament and they had made it clear that a return to the practice of

forced loans, common under the Stuarts, would no longer be tolerated and that the government would have to honor all its debts. Secondly, it was a way of making sure that the coinage would not be debased, as had happened during the epoch of absolute monarchy, when royal governments had shaved coins to reduce their gold content, enlarge emissions and cause inflation. In this sense, the independent central bank is considered to be a product of the democratic-bourgeois revolution and a limitation of the power of government to finance itself through inflation.

The orthodox position on the independence of the central bank is expressed by Rogoff, who maintains that the central banker must always be more conservative than the electorate in order to ensure that the economy is not harmed by the kind of short-term benefits that politicians offer in order to win votes. Thus, a politician who comes to power on a platform of greater employment may wind up causing an inflation that punishes the whole of society and especially the sectors he promised to help, since they are least able to defend themselves from it.

Elster, on the other hand, is more concerned by a problem which orthodoxy does not take into account: how to protect society from an excessively conservative central bank that makes mistakes and does not acknowledge them: “The real danger implied by an independent central bank is when it has a deflationary slant that unnecessarily subjects the economy to a great loss of Production”. (Fischer, 201). An inflation target regime allows the two contending powers to share the responsibility: the government fixes the inflation target and the central bank is free to employ whatever means it chooses to achieve it. The above mechanism addresses the problem of a need for an escape clause in the contract between society and the central bank and limits the powers of ultra-conservative governors whose actions may wind up magnifying economic depressions. (Elster, 2000, 167).

Now that Stiglitz has become so famous for opposing the orthodoxy of the IMF and winning the Nobel Prize for economics, I mention this to illustrate his politicized view of the central bank. His fundamental criticism of the independent central banks is that they carry out their monetary policy behind the backs of officials elected by the people. In the case of the United States, “the president is responsible for the performance of the economy, whether or not he exercises control over it . . . and he does not count upon the tools that affect the macro-economy”. (Stiglitz, 200-201).

Governments are tempted to utilize inflation in an opportunistic way, employing the powers that Stiglitz defends, in order to win an election or not lose a reelection, thus falling into the trap of time inconsistency in a flagrant way. As Jon Elster points out, “if the government has direct control over monetary policy, it may use that instrument to enhance its chances of being reelected rather than to serve the public interest. In this case, the separation of powers serves to counteract partisan interest”. (Elster, 2000, p. 153).

Stiglitz is partly right, but for different reasons, especially in saying that the central bank may exceed its powers. Many orthodox economists may not like Elster’s warning: “if the central bank oversteps its authority, the government should have some means of being able to counteract it”. A parallel example of this situation occurred during Roosevelt’s second administration, when the Supreme Court opposed a government with wide popular support: the government could legitimately have resorted to a

constitutional amendment that gave it a majority in the Court, but it did not have to go to such lengths because the Court stopped opposing the political program of the New Deal.

In this way, “when the courts and the central bank abuse their powers, the executive or legislative branches should be furnished with similar powers, so that these branches may be able to neutralize them when it becomes necessary to do so, by means of 2/3 majorities or other exceptional mechanisms” . Elster cites the case of the Norwegian central bank, which maintained the gold standard during the Great Depression, despite the fact that it caused a bigger and bigger loss of product. As a result, Norway passed a law that allows the government to remove the board of directors of its central bank in extreme situations, provided that it informs the congress beforehand (Elster, 2000, p. 166).

An essay of mine entitled “The Independence of the Central Bank and Democracy in Latin America” justifies this independence, not only because it checks the harmful effects of short-term political opportunism, but also because it responds to the division of powers that prevents rulers from abusing the kind of monetary emissions that harm society. In Latin America the division of powers is imperfect, due to a centralist tradition that gives excessive discretion to the executive, which is largely unchecked by the congress and a weak judicial power. Latin American governments frequently abuse their power of emission and have created hyperinflations that have caused a complete collapse of capital accumulation and destroyed much of existing wealth.

Among the conclusions of my essay, the following one seems to be particularly relevant to this situation:

Just as the high courts must be independent of the government which happens to be in power, so that justice is governed by law and not political interests or the particular ones of the government, so too the central bank must be autonomous of the government. But, like a supreme court, not entirely so: the executive should be able to replace some members of its board of directors, so long as this does not lead to a change in its composition that favors the interests of the government.

We may thus say that an independent judiciary and central bank provide citizens with a fairer deal in terms of a more moderate inflation and greater social welfare and justice. (Kalmanovitz, 45)

## **Conclusion**

Although there are many more aspects of the social theory of Elster that are of interest to economists, -- like his ideas about collective action, negotiation, technical change, as well as his profound analysis of Marx the economist and political theorist --- I restrict myself here to the ones I have dealt with, as a way of inviting economists to read this prolific philosopher who, once read, will lead us to question many of the most basic premises of our discipline.

His interpretation helps us to understand the strength of neo-classical theory, which derives from its ample capacity for mathematical formalization, but Elster also

highlights its use of a number of suppositions from which confusing or mistaken results may be derived. The rational agent is much less rational than is assumed and the limitations that affect his conduct must be taken into account. One's own preferences may be changed by the actions of the narcissistic ego, self-deception and the general volatility of the "I", which he has analyzed in his *Economics* (Elster, 1997).

Social norms enslave the majority of the population and reduce the range of possibilities for free choice. Emotions distort the search for rational objectives. Envy and a sense of "honor" still play an important role in the developed societies and it is worth adding that they have an even greater weight in countries which are barely developed or which have a Hispanic, Catholic heritage.

What is more, the suppositions about public choice are altered by many factors that weaken their validity: the cultural and traditional inclinations of the electorate, collective passions, the way politicians adapt to shifts in public opinion, etc. For the rest, constitutions are rarely explicit about economic subjects and thus public choices are not clearly specified.

Elster's emphasis on the role of political organization in economic performance establishes links between political scientists and economists. Our economists tend to concern themselves with the efficiency of the constitution, without thinking about the security it may provide, the legitimacy that it gives the State or the limitations that it should place on the exercise of power. Others wish it to be a *piñata* full of costly benefices. We should recognize that the Colombian Constitution of 1991 has been a form of social regulation and governing power superior to that bequeathed by the Catholic Jacobinism of the 1886 Constitution; the latter has shown its ability to weather the political and economic crises that vanquished our neighboring countries in 1998-1999.

Elster applies these political notions about the division of power and checks on the abuses of the central government to the independence of the central bank, without resorting to the conventional rhetoric of economists. That is, of those who exclusively regard this independence as a way of solving the problem of intertemporality, or those who criticize it as a way of supporting the executive's power to benefit everyone through full employment, with the argument that inflation or macro-economic imbalances are minor problems.

My final point is that Elster, in my view, reflects the state of the art of the contemporary social sciences. Advances in information theory and a greater awareness about the volatility of expectations, which are related, in turn, to the progress of experimental psychology, have led to a questioning of the foundations of neo-classical theory and forced it to be more modest about its results.

The language and methods of game theory employed by Elster are shared by the schools of economics, political science, psychology and sociology that are now being developed in the academic circles of Western Europe and the English-speaking world. The more radical academic domains of France thirty years ago, where Elster began his career,

were fairly distant from the possibility of reaching the objectivity which all sciences require,<sup>9</sup> though they still have many followers in our country and in Latin America.

This explains the purpose of the Elster workshop. By inviting eminent and rigorous thinkers who are promoting the development and expanding the frontiers of the contemporary social sciences, we hope to vitalize the intellectual atmosphere of our country, which has tended to ossify by incessant repetition of the radical traditions of ancient theories of social science.

## Bibliography

Elster, Jon. 1982 “Marxism, Functionalism and Game Theory”, **Theory and Society**, No. 11.

Elster, Jon. 1983 “The Crisis in Economic Theory”, **London Review of Books**, 5(9)

Elster, Jon. 1983B **Sour Grapes**, Cambridge University Press, Cambridge.

Elster, Jon. 1989 “Social Norms and Economic Theory”, **Journal of Economic Perspectives**, 3 (4)

Elster, Jon, 1989 B **Ulises y las sirenas: estudios sobre racionalidad e irracionalidad**, México, Fondo de Cultura Económica.

Elster, Jon. 1989C **The Cement of Society**, Cambridge University Press, Cambridge.

Elster, Jon. 1994. “The Impact of Constitutions on Economic Performance”, World Bank , Washington.

Elster, Jon. 1997. **Egonomics**, Editorial Gedisa, Madrid.

Elster, Jon. 2000. **Ulysses Unbound**, Cambridge University Press.

Fischer, Stanley. 1995. “Central Bank Independence Revisited”, **American Economic Review**, May.

Kalmanovitz, Salomón. 2000. “La independencia del banco central y la democracia en América Latina”, **Revista del Banco de la República**, No. 875, septiembre.

North, Douglass, Barry Weingast. 1996 “Constitutions and Commitment: the Evolution of Institutions Governing Public Choice in Seventeen Century England”, en Lee J. Alston, Thráinn Eggertsson, Douglass C. North, **Empirical Studies in Institutional Change**, Cambridge University Press, Cambridge.

---

<sup>9</sup> Just as he points out in his masterly essay: “Going to Chicago” in *Egonomics*. It reminded me of Marcelo Torres of the Colombian political party, “MOIR” ( Independent Revolutionary Workers Movement ) who labeled the ideas of Trotskyists like myself as “eclectic French hogwash” in 1970.

Pedroza Florez, René. 2000 “Teoría de juegos e individualismo metodológico de Jon Elster”, **Cinta de Moebio**, No. 8, Universidad de Chile, Santiago.

Rawls, John. **Teoría de la justicia**, Fondo de Cultura Económica, México, 1979.

Rodríguez, Jorge Armando. 2001 “El Estado unitario descentralizado: Una crítica al enfoque constitucional colombiano”, **Cuadernos de Economía**, No 35.

Rogoff, Kenneth. 1985. “The Optimal Degree of Commitment to a Monetary Target”, **Quarterly Journal of Economics**, No. 100.

Rutherford, Malcom. 1996. **Institutions in Economics**, Cambridge University Press, Cambridge, England.

Sen, Amartya. 2000. **Desarrollo y libertad**, Editorial Planeta, Barcelona.

Stiglitz, Joseph 1998. “Central Banking in a Democratic Society”, **De Economist** 146, No2, , Holland.