Part I:

Analytical History:

Rational Choice, Evolution and the Emergence of Parliamentary Democracy

Chapter 2: Organizational Evolution and the "King and Council"

1. Organizations as Instruments of Collective Action

Historically, governments emerged as one of many types of organizations as human society itself emerged in the distant past. All organizations share the property that they are formed to advance goals that can best be achieved by coordinating the efforts of more than one person. This is true of even the simplest organizations in which fellowship its the organization's only objective, and being organized is an end in itself. And, it is also true of large and complex organizations whose aims concern people, places, and activities beyond their membership. Formal organizations may be as small as a two person team of hunters or gatherers, or as complex as contemporary national governments and international organizations such as Toyota, the Red Cross, the World Bank, and European Union that address policy issues of immense complexity. They include voluntary associations formed to advance shared interests such clubs, firms, cooperatives, and churches, and many organizations whose memberships are not entirely voluntary such as governments that are organized on the basis of families, clans, or territories.

All formal organizations confront similar decision and incentive problems. Regardless of size or purpose, formal organization make decisions that focus the organization's resources on particular activities, and induce their members to function as a more or less productive team rather than an unproductive assembly of individual shirkers and rent seekers. The members of a hunting club, church, firm, or government meet at a common place and time. Those places and times have to be selected and incorporated into the plans of all in order to generate many of the benefits associated with the organization's activities. Once gathered the groups must be induced to hunt, worship, produce, and govern. In the terms of contemporary game theory, all durable organizations must overcome a repeated series of coordination, prisoner's dilemma (PD), and prisoner's dilemma with exit (PDE) problems. Consequently, all organizations have evolved through time as the details of the problems confronted change and as new solutions emerge from a mixture of intent and luck as new solutions to these old problems are put to the test.

The common "decision" and "management" problems of organizations allows each form of organization to learn from the experiments of others. Many experiments are tried by both governmental and non-governmental organizations, and a few succeed while many fail. Others succeed, but only within relatively narrow circumstances. The results of this process of experimentation are not always widely available, but through time it produces information sufficient for a process of selection to take place in which well functioning and robust decision methods and reward systems are adopted or adapted for new organizations. It may turn out to be the case that only a fairly narrow range of institutions work effectively in a variety of environments for a variety of organizational purposes and organizational memberships, or it may simply be the case that only a few of the possible solutions have yet been discovered. In either case, the menu of institutional designs—long-standing decision procedures and internal reward systems—available to "formeteurs" will be fairly limited in their essential details.

Although in principle, there are many ways that an organization's objectives and strategies can be chosen and many ways that individuals can be motivated to cooperate in teams, it would be very convenient if in practice only a few general solutions are used, whether because of their efficiency properties or bounded rationality. If so, the theory of formal organizational design can be far simpler than are the organizations themselves, the problems addressed by them, or the environments in which they function.[1]

Of particular interest for the purposes of this book is a commonplace solution to the organizational governance problem that I call the "king and council." This solution divides responsibilities for choosing an organization's policies between a single person—a chief, king, proprietor, or president—and a committee of more or less equals—a tribe's wise men, royal council, board of directors, cabinet or parliament. The power to make policy decisions can be divided between the King and Council in a great many ways, and it is partly the flexibility of the "king and council" form of governance that makes it so useful and robust. It is also partly this continuum of authority that allowed parliamentary systems of governance to emerge more or less peacefully in the nineteenth century.

In this chapter, I argue that the "king and council" template is a robust method of solving information problems and for resolving some kinds of organizational

[1] Elinor Ostrom (2005), for example, suggests that there are relatively few stuctures, or at least those that contemporary institutions can be classified into a reasonably small number of types.

conflicts that tend to emerge as organizations become large or attempt to advance complex goals. It is flexible template for governance, and allows a variety of decision making procedures to be implemented, any instance of which can be adjusted to address new circumstances. These properties have lead it to be used in a very broad cross section of political systems and for governance within other large long-standing organizations. In the next chapter, I argue that a particular application of this template to political organizations—namely constitutional monarchy—allowed parliamentary dominance to peacefully emerge in the nineteenth century.

2. Forming a formal organization

To begin with, all formal organizations have a beginning. That is to say, formal organizations are initiated by some individual or group of individuals with particular purposes or goals in mind. A swamp is to be drained or protected, a village is to be defended or attacked, new product is to be made and sold, an important idea is to be promoted, international trade is to be encouraged or discouraged, privileges are to be created or eliminated.

Many formal organizations also have an end. They may end when their goals have been achieved or when they fail because they are not self sustaining. Some organizations only function well because they include a particular constellations of personalities and talents, and disband when those members leave. For example, a founding individual or group may retire or die, and their organization may not be able to function without their particular solutions to decision and team production problems. In other cases, organizations may cease to be "self sustaining" and their members may leave for other organizations because they no longer receive sufficient compensation from participating in the organization, possibly because other attractive alternatives have emerged, possibly because the organization itself fails to solve its internal team production problems.

Hunting clubs must produce food to be self sustaining. Economic enterprises must produce sufficient revenues to pay their employees, but also produce profits for entrepreneurs. Churches must attract sufficient donations to maintain their clergy and physical structures, but also a surplus for expansion and assuring comfortable lives for the church leadership. Governments must have sufficient tax resources to retain control over the territory of interest, but also enhance the lives of the formeteurs—whether a crown or a broad citizenry.

Many organizations are hundreds of years old, but new organizations are created every day. New organizations may be constructed by a single formeteur with his or her own narrow purposes in mind, as often assumed by economists about the origins of organizations with profit as their goal, firms. Or new organizations may be formed by a group that wishes to pursue common purposes, as often assumed by political philosophers interested in contract-based theories of the state, treaty organizations and voluntary clubs. In between these extremes are cases in which a small group organizes a larger one to advance the smaller group's interests, as when a group of investors create a new firm or division to produce a new product, and cases in which a larger group organizes a smaller one to advance the common interests of the larger group, as might be said of efforts to organize representative systems of governance within firms by shareholders and other stakeholders.

Organizations are a flexible technology that can be used to advance a wide range of goals. This is evident in the enormous variation in the services produced by organizations today and which have been provided by them throughout recorded history. Organizations also vary enormously in size and in coercive power. On the other hand, there are common problems that have to be addressed within all formal organizations, and common criteria for judging the success of those solutions. Except in the very unusual case in which an entire society is the formeteur, organizations will not be designed to maximize the organization's output or society's surplus, but rather attempt to maximize the net benefits or profits of the formeteur(s), whether this be financial, personal, social, or spiritual. The decision making procedures and reward system of organizations, thus, tend to reflect the aims of their founders or "formeteurs," rather than accident or broad collective objectives.

Formateurs and organizational governance

A rational choice representation of the interests of formeteurs implies that existing organizational decision making arrangements and the internal reward structure of new organizations are best of the known alternatives, in the sense that they most effectively advance the interests of formeteurs. All formeteurs prefer effective to ineffective organizations and lower cost methods of coordination and production to higher cost ones. Although these common design criteria may generate solution that vary somewhat because of differences in risk aversion, they will have common effects on every organization's internal structure—on what makes an organization an organization rather than simply a group of individuals.

If formeteurs knew the properties of every constellation of decision making procedures and internal incentives, they would pick the most efficient ones, because this maximizes the resource they have available to advance their goals and/or the goals of the organization. If this full constellation is not known or has properties that cannot be fully imagined, they will adopt the most efficient systems of government and internal systems of reward that they can understand. In this manner, the design criteria of formeteurs may lead to considerable convergence among organizations whenever a relatively small class of efficient solutions exists or has so far been discovered by previous organization entrepreneurs.

Limited knowledge of the properties of alternative solutions, also provides a reason for organizational experimentation, although formeteur interests imply that experiments will only be undertaken if they are thought likely to improve an organization's performance. Such experiments will be undertaken for example when new theories of organization emerge or circumstances change, others may be undertaken through chance events of various kinds, as when responsibilities are redistributed because of illness or poor weather. In this manner, the menu of existing decisionmaking procedures and reward systems available to organizational entrepreneurs at a given moment are evolutionary products of trial and error. Only those that have succeeded well enough to be copied by other formeteurs, and hence present well-known organizations (and organizational casebooks).

The most common systems of governance, thus, will on average correctly identify opportunities for increasing formeteur surplus and their internal systems of reward will solve the most common organizational incentive problems at a relatively low cost. These almost tautological characteristics of organizational design in the long run can be deepened a bit by analyzing in more detail how few typical internal incentive and decision problems can be solved.

Solving internal incentive problems of a joint enterprise

In principle, both the rules and payoffs of "the intra-organization game" can be manipulated by formeteurs to achieve the desired team behavior. Economics suggests that these games and reward systems will create settings in which team members are rewarded for taking actions that increase net benefits for formeteurs. In modern organizations, the most obvious conditional-reward structures are those associated with wages, salaries, and promotion within the organization. Private firms, large charities, and public bureaucracies motivate their employees in part by making individual salaries and positions within the organizational hierarchy conditional on showing up to work and being a productive team member. However, money is rarely the only reward used to solve team production problems.

Economics suggests that formeteurs will be inclined to minimize the overall cost of the financial reward system for a given problem, because this maximizes the extent of resources available to solve other problems or for the formateur's own uses outside the organization. In the illustration below, the team production problem can be solved by changing the initial system of rewards. Let the new supplemental reward for work be R and the new penalty for shirking be P. Note that both players work to advance team goals if $3 + R > 4 - P$ and $1 + R > 2 - P$. Note that any system of rewards with $R > 1$ and $P > 1$ will solve the team production problem. If formeteur costs increase with rewards and penalties, he or she will choose to set R just a bit above 1 or set P a bit greater than 1. If punishments are less costly than rewards, the formeteur will be inclined to use penalties rather than rewards to encourage productive effort.

In many settings, however, team members are volunteers in the sense that they are free to exit and join other organizations or work alone, and the formeteur faces a PDE (prisoner dilemma with exist) problem rather than a simple prisoner's dilemma problem to solve. The exit option limits the extent to which penalties can be imposed on team members. In the example, exit implies that the formeteur cannot use penalties greater than 0.5 without risking exit by some or all team members. In this case, a combination such as $P=0.5$, $R = 0.5$ might well be the best solution for the formeteur, a mixture of "sticks and carrots." In general, the extent to which penalties can be used, varies with the frequency with which they are applied, the expected rewards that otherwise are received by team members, and the alternatives available to team members or employees.

Table 1

The Shirking Dilemma Game for Team Production

	Team Member B	
	Work	Shirk
Work (A)	3, 3	1,4
Shirk (A)	4, 1	2,2
Exit (A)	1.5	1.5

Organizational Solution to the Shirking Dilemma

	Team Member B	
	Work	Shirk
Work (A)	3+R, 3+R	1+R, 4-P
Shirk (A)	4-P,1+R	2-P, 2-P
Esit (A)	1.5	1.5

The cell entries are utilities, the rank order of subjective payoffs for the team members (A, B). The dilemma in the "natural case" is that both team members shirk rather than work.

The rules of the game may also be adjusted to maximize the effect of given rewards on individual effort. Contests between fellow employees may be devised to maximize the effects of rewards and punishments—promotions and demotions—are determined by relative rather than absolute performance.

It also bears noting that financial incentives are not the only conditional rewards employed by organizations to solve these their PDE and coordination problems. Both R and P may consist of combinations of non-pecuniary and pecuniary benefits or punishments. For example, an organization's membership or employees might be encouraged to do "show up" and do "good work" (work that advances the organizations objectives) by granting them praise, status, and informal perks for past performance rather than or in addition to money. In a society that includes a work ethic among its norms, this reward and punishment system might function freely as fellow team members award higher status to hard workers and low status to shirkers. Similarly, an organization's membership or employees might be motivated to "show up" and do "good work" as a consequence of the organization's internal culture of work (Congleton, 1991). Norms may emerge that predispose team members to be conditional cooperators (Axelrod 1984, Vanberg and Congleton 1992 and 2001).

A formeteur may, thus, attempt to develop an internal organizational culture of work or participation that induces members to "internalize" the goals of the organization. If successful, individual members feel worse off when they act in a manner that conflicts with organizational goals even in cases in which his or her performance could not be observed by anyone else. Formateurs may also attempt to select team members that are likely to be effective team members. Insofar as some potential members or employees are easier to motivate than others, are more intrinsically motivated to advance organizational goals (e.g. those of the formeteur), or are simply more talented at performing the tasks at hand, costs can be clearly reduced by attempting to attract such people to the organization. The success of selection and non-pecuniary reward systems is evident in the existence of significant organizations that pay team members little or nothing for their contributions, as within many small voluntary clubs, academic societies, political interest groups, religious groups, and armies.

Intrinsic and informal rewards are, however, normally reinforced by explicit conditional pecuniary rewards and penalties. Team members that develop reputations for shirking or poor performance, may lose status among their peer, but also suffer from diminished prospects for bonuses and salary increases.

Economics implies that if a variety of methods can be used to achieve the same end, formeteurs will use the combination that is least costly to implement, other things being equal. Consequently, formeteurs often use a variety of motivational devices to solve the team production problems within their organizations. In the example above, R>1 is would be achieved through the cost minimizing combination of non-pecuniary and pecuniary rewards. Here it bears noting that religious and governmental organizations are among the most long-lived organizations, and both these types of organizations make extensive use of internal culture, selection, and financial rewards—roughly in that order—to motivate their members.[2]

However, it also bears noting that not all motivational devices are equally available or subject to manipulation by institutional designers. Some organizational goals are clearly connected to broader societal norms than others, some persons are more interested in promoting those norms than others. Religious orders, governments, and ideological interest groups can evidently use nonpecuniary motivational devices more readily than many other organizations, as membership is largely determined by those placing the greatest importance on particular norms or beliefs.

[2] Here one may note the emergence of cooperative norms within simulated joint enterprises in the work of Axelrod (1986), Boyd and Richerson (1992), and Vanberg and Congleton (1992, 2001). In all these studies, organizations were more viable when norms of conditional cooperation were widespread within game settings similar to the team production settings of interest here. In the long run, organizations that include relatively more conditional cooperators tended to be both more profitable for members and more durable.

Of course, firms, economic interest groups, and criminal gangs, also attempt to build loyalty to their respective organizations and also attempt to promote an internal work ethic, but some organizations have a comparative advantage at using the external culture and building useful internal norms. The processes required to create entirely new subcultures are not fully understood, and evidently are not be fully designable in any case. Consequently many potentially effective nonpecuniary reward systems are too costly to be used or manipulated, or simply impossible.

This difference in feasible reward system partly accounts the fact that particular types of organizations tend to dominate the provision of particular types of services. Organizations that can easily produce a supportive internal culture are be more likely to succeed in a given enterprise than ones that can not, because their costs are lower and their effectiveness tends to be greater.

On the other hand, there are costs as well as benefits associated with the use of informal reward systems.

Informal rewards and rational institutional conservatism

Whether informal reward systems are products of design or not, they have to be taken into account when major reforms of an organization are contemplated. Well-informed formeteurs and senior managers will understand that their existing nonpecuniary reward systems are difficult to change, difficult to fully assess, although they are understood to contribute the organization's effectiveness. Any changes that might undermine or conflict with an organization's supportive culture, will tend to increase costs and/or reduce effectiveness.

In this manner, reliance on informal incentive structures often tends to reduce experimentation because it increases the likelihood that reforms will decrease rather than increase effectiveness and efficiency. That is to say, the very success of informal incentive structures tends to induce a strategy of "rational conservatism" on the part of successful formeteurs and their successors. They fear that experiments would undermine a system that they do not fully understand.

Rational conservatism is further encouraged by the methods through which an organizations personnel are replaced through time. Organizations such as governments, large firms, and large charities have many levels of more or less self-sufficient internal institutions, and, thus, many levels of nested games and established routines for participating in those games that have to be learned as employees pass between levels. The use of "off the shelf" methods of reward and assignments of responsibility allows personnel to be easily shifted within the organization and also allows new personnel to be added from other organizations with lower training and acculturalization costs than possible when reward structures are radically reformed or extremely unusual. An organization's routines, theories, and norms, thus, are passed on to successive generations of participants and personnel as the current members teach new members the methods for getting along and succeeding within the organization. In this manner, many of the non-pecuniary reward system, as well as aspects of its decision making procedures, may become *customs or dogma*—unwritten but durable rules of conduct within a long standing organization.

Within a stable environment, particular solutions to intra-firm decision problems may thus dominate for long period of time not because the organizational form is perfect, or because formeteurs are extremely risk averse about organizational experiments, but because the cost of significant reforms exceed their benefits given the combination of external and internal culture in which organizations operate.

A self-generated and renewing culture may, thereby, increase the problems that an organization must overcome to adjust to new circumstances or profit from new organizational theories. That is to say, at the same time that informal reward structures increase the performance of an organization's team, a stable organizational culture tends to limit an organizations ability to undertake major organizational experiements—changes in decision making procedures, reward systems or goals—because many such experiments will undermine or be undermined by a firm's culture.

Insofar this effect is anticipated by formeteurs and small experiments are less likely to threaten this internal culture, it encourages them to adopt "flexible" institutions: reward and decision making systems that can be adjusted at the margin. For example, reward systems that include cash payments to individual team members can be easily be adjusted at the margin to redirect resources within an organization than can promotion and all inclusive sharing rules, which may be supported by particular norms. Similarly, decision making procedures that allow responsibilities to be adjusted at the margins to better address new circumstances will tend to work better in the long run than rigid systems that require discrete "revolutionary" shifts organization.

The “king and council,” system of government provides just such flexibility, as demonstrated below.

3. The evolution of organizational governance: informational dilemmas and solutions

The decision making process of an organization share many of the properties of its ordinary productive activities. They are often procedures that require active effort by several people to work properly, and they may use a variety of incentive devices—not all of which are pecuniary—to encourage that participation. They may also have to be adjusted through time as circumstances or theories change. Again formeteurs have reasons to attempt to minimize the cost of the incentive scheme used and have reasons to prefer somewhat flexible to inflexible systems. Corporate governance, however, contributes more to a firm’s success in unstable circumstances than during stable circumstances, because it is at such times that decisions have to be made.

In a perfectly stable environment, an organization’s decision making procedure is not central to its success beyond it role in creating and sustaining an internal system of rewards to solve team production problems. These can for the most part be addressed by copying those of other successful organizations. In unstable circumstances, however, an organization’s decision making process is central to an organizations survival and success, because a variety of adjustments become necessary to advance formeteur interests and maintain the organization through time.

In some cases, instability may be self generated, as when an organization’s past success causes its size and/or scope to increase in a manner that reduces the effectiveness of long-standing decisionmaking procedures. For example, growth may reduces the effectiveness of an organization’s internal culture at solving multilateral PD games and coordination problems by increasing the number of persons who must be motivated while increasing the anonymity of team members. In other cases, there are unexpected external changes that have to be taken account of. The cost of inputs or may change, because of increased competition from other similar organizations or technological change. The relative value of longstanding goals and rewards may change as ideology and norms shifts among formeteurs and members of the organization.

During such times, an organization’s decision making process becomes critical to its survival and success. It has to be able to collect and process information in order to recognize that changes have indeed occurred, and to accurately assess the relative merits of strategies that can be used to address the new circumstances. Not every change in policy is an improvement, and not every change in circumstance requires new policies or institutional reforms.

Formateurs and their successors clearly have common interests in effective decision making procedures that will again generate some convergence among the techniques used by organizations to make decisions. It is clear that some decision making procedures are better at “information processing” than others. For example, any process of policy that ignored changes in circumstances cannot adjust to avoid problems associated with those changes to realize new opportunities associated with such changes. Thus, completely rigid policy making and random selection are unlikely to be effective decision making procedures, because they do not, by definition, take account of new information. Such procedures are acceptable, only if useful information is unavailable. In settings in which experience and other information can be used to improve future plans, such decision making procedures will be less effective on average than others available to formeteurs.

One common solution, especially for small organizations, is for the formeteur(s) to undertake organizational governance themselves. Formateurs know their own goals for the organization better than others are likely to, and their role as formeteur(s) implies an ability to use information and manage people. Formeteurs usually have “leadership skills” that allows them to form groups at lower costs than other potential formeteurs. Leadership often has an informational base, the ability to persuade others that it is in the interest of team members to defer to formateur’s leadership, because he or she, or a small group of wise men and women, understand what is possible better than they do. A superior understanding of organizational possibilities may, of course, also produce a relatively intense desire for the organization’s services, which justifies a substantial investment in assembling a team and devising methods to advance particular goals.

Many organizations have a founder, a single clever person who gathered a group together, and created an effective team by establishing a decisionmaking process and reward system for the group assembled. This is true of firms, churches, and governments. In other cases, a relatively small group of formeteurs initiated the undertaking, as is also true for firms, churches and governments. In the long run, however, it is often in the interest of formeteurs to relinquish part or all of their control.

What is of interest here is the extent to which convergence takes place among the organizational governments that emerge, because formeteur interests are fundamentally similar and relatively few organizational solutions exist.

The ”proprietor’s informational dilemma

For, purpose of analysis, let us assume that a single formeteur initially chooses to run “his or her” organization as an autocrat. Of course, this is not the only possible decision making procedure, but it is a reasonable place to start. Clearly, the formeteur is in the best position to know his or her own interests, and as founder reveals that he or she has a reasonably clear impression about how an organization may be created to advance those interests.

However, in unstable settings, subsequent formeteur decisions will require a good deal of new accurate information about the internal operation of the organization in order to make effective use of the team assembled and to improve the organization as its relative weaknesses and strengths and new opportunities (comparative advantage) are revealed through time. Wintrobe (1997) argues that every autocrat faces several kinds of information problems. First, an autocrat faces the same information problems as an ordinary person. An autocrat has to decide how much information to gather about every dimension of policy, which information sources should be believed, and how much of the information gathered to share with others. Second, an autocrat confronts a series of information problems that are associated with the power of the position held. Much of the information available to him will be intentionally biased whenever individuals, especially those within the organization, can benefit from manipulating the autocrat in some manner. For example, personal careers may often be advanced by exaggerating their loyalty and performance relative to other rivals within the organization. Wintrobe (1997, Ch. 2) refers to this filtering aspect of a ruler’s informational problem as the “dictator’s dilemma.”

Third, the problem of getting useful information is compounded by a greater need for accurate policy information than that of individuals with less control over the organization. The scope of a proprietor’s policymaking ability is clearly wider than that of other members of the organization, and, consequently, so are the number of alternatives that must be accurately assessed if he or she is to make policy decisions that advance his own interests. Together, these imply that in most cases it will be difficult for any single individual to independently gather sufficient information to make accurate policy assessments, and the larger the organization and more complex the goals and operating environment, the more difficult it tends to be to make good decisions.

One widely used “oganizational technology” for reducing a proprietor’s information costs is the advisory council. The advantages of advisory committees can be demonstrated for two quite different settings in which a proprietor assemble a council of advisors.

Advisory councils for well-informed proprietors

Consider first a fairly well-informed proprietor with “rational expectations” over the consequences of alternative policies, and thereby of the relative merits of policy alternatives. Such a proprietor will not make systematic policy errors and consequently, on average, will choose policies that maximize his expected utility. Yet a proprietor like any other person will economize on data and collect it only up to the point where his expected marginal benefits equal his marginal cost. Clearly, ordinary statistical theory implies that the smaller the data set, the greater the errors, other things being equal. Consequently, there are circumstances where it pays the proprietor to use part of his data collection budget to assemble a council and pay council members for their advice (either directly in cash, or indirectly through favors and privileges).

The advise of a panel of non-experts chosen at random from his organization (or citizenry in the case of a governmental organization) will tend to be less informed than the proprietor because such persons lack an encompassing interest in the organization. However, advice from such a council may still be informative insofar as they have different personal experiences or training. Thus the sum of the information within a council may in many areas include more information that possessed by a relatively well-informed king. In addition to this advantage, insofar as the samples of the proprietor and council members are independent of one another, their predictions about future events are also independent and may be approximately unbiased. The average of several unbiased estimates is generally a better estimator (more accurate) than any one of the estimates averaged, and better than a single estimator based on a smaller data set. Together these two effects imply that a council of advisors can be a cost effective method of aggregation if the value of the additional information and more precise estimates is sufficient to warrant advisory compensation.

In many cases, the proprietor can do better than a randomly assembled council, by for example assembling a panel of especially well informed individual whose understanding of the world makes their forecasts less likely to be biased than the average member of the organization. Some potential councilors simply have a comparative advantage at gathering and processing information because their opportunity cost for assembling and processing information is substantially below that of the proprietor, or their talents as information processors is greater. This comparative advantage is partly endogenous, and can be increased if the proprietor constructs competitive games for council membership that reward policy relevant information acquisition with status or lucrative salaries. In some cases, contests can be extremely effective, inducing greater investments by the players than the sum of the rewards given out, as true of even simple lotteries (Tullock, 1980). Moreover, payment in *positional goods* can be quite inexpensive for the proprietor, yet encourage substantial efforts by prospective councilors (Hirsch, 1995, Frank, 1985, Congleton, 1989). Being councilor to the proprietor (CEO or King) may also produce other consulting opportunities as well as status.

Informational gaming opportunities for council members are fairly limited in an environment in which the proprietor is sufficiently informed about policy consequences that he can form unbiased estimates of policy consequences, and is consequently able to reject, as implausible or as outliers, any obviously manipulative "estimates" by the council or council members. Thus, potential gains from organizing a committee of advisors can be significant in a setting where the proprietor has rational expectations about policies. The number of policy mistakes (and thereby policy risks) tend to fall as a result of cost effective advice. In this manner, a well-informed supremely powerful proprietor can benefit from the advice of a somewhat representative council—even when individual council members are less informed than the proprietor.

The informational problems change significantly as one shifts from a setting where the proprietor and all councilmen have complete although finite samples to one where both the proprietor and councilors remain rationally ignorant about some policy sub fields or some policy consequences. Here completely *unbiased estimation is not possible* by the proprietor or his councilors (Congleton, 2000). The impossibility of independent unbiased estimation increases the potential gains from additional information but also increases the risk of manipulation. That is to say, a council can potentially reduce policy mistakes by a rationally ignorant proprietor by reducing the variance of his estimation process, as in the previous case, and now can also reduce the bias of the proprietor's estimates of policy consequences. On the other hand, the council's scope for influencing decisions by manipulating the proprietor are potentially larger in this setting, particularly in policy areas where the proprietor remains essentially uninformed.

One method of addressing the problem of ignorance is to assemble a council that includes members beyond the proprietor's immediate circle (from whom he already receives incidental, common, or "received wisdom"). A council whose membership extends beyond the "court" tends to include *more complete information.* That is to say, it not only includes a larger sample of information, but also sample or cross section of knowledge that includes *more kinds or dimensions* of information than the proprietor could or would be inclined to assemble on his own. An honest council of this kind can clearly reduce rational or other ignorance at a relatively low cost. [3]

However, in order to profit from council advice in areas where the proprietor is essentially ignorant, the organization of the council must overcome the "dilemma of experts," the difficulty of taking advice from knowledgeable persons whose information can not be readily appraised, *ex ante*. (In the previous rational expectations case the proprietor had his own independent and unbiased estimates to use as a reference point, here he does not.) Relatively short-term forecasts and advice can often be directly checked by the proprietor as events unfold, but longer term advice remains problematic to assess. And, of course, even bad short-run advice can be disastrous for the proprietor.

[3] The more extensive information set of such extended or representative councils partly reflects differences in backgrounds (military, business, church, agriculture), partly chance events which bring before them different bits and pieces of knowledge, and partly talents that lead councilors to more efficiently collect and process information. These natural differences can be magnified when specialization among councilors is encouraged. Although every councilor may be ignorant about some policy consequences that the king is well versed in, their areas of ignorance would not entirely overlap. (In the context of the model developed in the appendix, some may specialize in information about ΔY and other about ΔT.)

Beyond gauging advice based on past performance, the proprietor can attempt to organize his council to minimize strategic information problems. There are several ways he can attempt to address the problem of information manipulation. The simplest method is to assemble a council that includes persons with well understood but conflicting interests who possess overlapping knowledge or expertise. Such a council can be assembled by having interest groups (guilds, land owners, the clergy, etc.) propose policy experts or representatives to the proprietor's council. Such a more or less "representative" council implies that the proprietor will hear a wider range of policy assessments from predictable policy interests, and that the *median* or average of the opinions heard is fairly well-informed and unbiased insofar as the council as a whole lacks a policy interest that differs *systematically* from that of the proprietor.

In this setting, thus, there is a practical reason for assembling somewhat representative councils staffed by members of organized special interest groups. In the case of rational ignorance, informational advantages alone can justify somewhat representative councils or parliaments. Moreover, both the size and representativeness of *advisory* councils can be varied to maximize the proprietor's informational advantage. In principle, the size and representativeness of the advisory council can be varied to the point where the marginal cost of a larger more complex council equals approximately the expected marginal informational advantage of improved public policies (e. g. those that advance the proprietor's interest in the present context).

A well-informed board of directors also can use a chief executive

The analysis to this point may be taken to suggest that organizations founded by a small group of formeteurs may exhibit superior performance to one's founded by single formeteurs. They will tend to function as a committee of experts and thus tend to have superior ability to make use of information about opportunities for their organization. On the other hand, even a small group may not be able to take full advantage of this informational advantage, because individual members tend to lack a fully encompassing interest in their organization's operation. Each member of the board of director's after all receives only a fraction of the organization's surplus or profits. Monitoring the organization's operation is an exercise in team production for the council, which can not easily solve the problem of monitoring and encouraging its own behavior.

Such organizations may, thus, benefit from delegating responsibility for managing the organization on a day to day basis to a single person, a chief, CEO, or prime minister, and use a combination of conditional pecuniary and nonpecuniary rewards together with a selection process to address incentive problems associated with delegation. Such a chief executive or administrator will have in the ordinary course of his affairs much greater knowledge of the specific details of policy implementation than any external council member would be inclined, or able, to assemble. A chief executive directly participates in the execution of policy and therefore acquires relatively complete and detailed knowledge of the process of implementing policy within the organization. Insofar as compensation is sufficient to produce competition for the post of chief executive, many individuals will have an interest in acquiring the relevant information and thus some redundancy in information sources will naturally occur, which reduces monitoring costs for the council.

In this manner, a chief executive or a subset of the board of directors (the "prime" minister) may become experts about procedures and possibilities for implementing policy generally, or in specific policy areas. The previous analysis of team production suggests that cost minimizing combinations of pecuniary and non-pecuniary rewards will be used to motivate the CEO, and the effectiveness of these reward systems will be improved by selecting CEO's who are easily motivated to advance formeteur interests and have the talent to do so. It also suggests that optimal combination will vary somewhat by organization and circumstance insofar as these affect the strength of incentives that are required to align the CEO's interests with those of the organization and also the possibility of using selection and nonpecuniary rewards to reduce the cost of the CEO's compensation package. Again the use of these last two techniques does not imply that "self-interest" is unimportant, but rather that self-interest broadly understood accounts for a person's own norms and routines and as his or her need for approval, respect, status, and fame.

Delegation to a King and Council

In cases in which the formeteurs consist of a large group of individuals, management of the organization may similarly be delegated to others for more or less similar reason. For a large group of formeteurs to meet and debate alternatives every time that a decision has to be made is clearly both time consuming and inconvenient, and consequently it often makes sense to meet only to make decisions that have major consequences for the formeteurs. For lessor decisions with relatively minor effects on formeteur interests, it will be convenient to delegate authority to others. Here, one can easily imagine a collective decision to delegate decisions to a representative council or a trusted proprietor that can be replaced by the "committee of the whole" if they fail to consistently advance the interests of the formeteurs. As in the previous cases, there are informational reason for a council to subsequently select a chief executive and for a proprietor to appoint an advisor council, so in this case as well, the "king and council" template may describe the decision making process of the cooperative's government.

In this case, however, there is another reason why the "king and council" template might be used, which is partly informational and partly an incentive devise. The cooperative may ask the council to report on the chief executive and the chief executive to report on council at the occasions when the formeteurs meet as a body. In this way, the increase the likelihood that more or less honest accounts of the organizations activities are made. The cooperative may also divide decision making authority between an executive and council as a method of reducing problems associated with selection mistakes, cases in which a relatively difficult to motivate (of control) proprietor or council is chosen by mistake. Recall that part of the aim of a selection process for personnel, which the cooperative's government is in this case, is to find people's whose interests are easily aligned with those of the formeteurs. The agency problems associated with such mistakes may be partly overcome by granting each part of the cooperative's government the opportunity to review and veto significant decisions made by the other. In this manner, a single selection mistake will not be catastrophic for the formeteurs, and the review process itself may improve such decisions by aggregating proprietor and council information, and also by encouraging compromises which tend to average the interests of the proprietor and council interests and thereby tend to better advance formeteur interests.

4. The Emergence of Divided Governance

The previous section provides an informational rationale for why we rarely observe a king without a council and a council without a king. An advisory committee may improve a proprietor's information and a chief executive may similarly improve the information available to a board of directors. Both an advisory committee and a chief executive officer can be given the responsibility of gathering useful information, which allows the formeteur(s) to devote their time and energy to other matters. Insofar as both incompetent and dishonest advisors are routinely eliminated from such positions and useful advice is rewarded more generously than in the occupational alternatives available to advisory committee members of CEOs, advisors will tend to truthful with their advice and generous in sharing their stock of private knowledge.

The informational analysis, however, does not provide a rationale for moving beyond this nearly polar forms of the "king and council" template. There are again two settings that illustrate the core advantages and costs of power sharing. First we analyze a hypothetical setting where a proprietor may choose to grant some policymaking power to his council of advisors, and second a more realistic setting in which the proprietor is dominant but not in complete control of his entire organization.

The common element of both settings, as it turns out, is that there are often mutual advantages that a king and council can realize by shifting power between them. That is to say, *policymaking power can be used as a tradable good* in a voluntary exchange between king and council. These gains from trade are not always, or perhaps even usually, entirely internal to the organization, but are often generated by relevant changes outside government. However, even without external shocks, such gains from trade often exist. For example, modest grants of power to the council may be used by a proprietor as a relatively inexpensive form of compensation for council members, especially for those with a direct financial or ideological interest in the organization's policy.

In more realistic settings, where the proprietor is the most powerful person in the organization, yet lacks the power to costlessly impose his will on all within the organization, power sharing may be jointly adopted by a proprietor and a council composed of others within the organization as a means of reducing losses from intra-organizational conflict. The advantage of avoiding the losses associated with both "civil" and "uncivil" warfare among power centers within a given organization are illustrated in Table 2.

Table 2
Asymmetric Power Game

	Stronger Party

		Little Aggression	Moderate Aggression	Intense Aggression
	Little Resistance	**6, 14**	3, 16	0, 18
Weaker Party	Moderate Resistance	7, 10	4, 12	1, 14
	Intense Resistance	8, 8	5, 10	**2, 12**

Table 2 illustrates some essential features of an asymmetric game of political conflict in a setting where two parties clash over the control of some policy, territory, or theology. Suppose that the weaker of the two parties is able to resist the stronger, so that complete domination is either impossible or at least is very costly for the stronger party. (In the case where the stronger party can simply conquer the weaker and dictate terms, a "kingdom" or autocracy may be said to be the result, as in the upper right hand cell.) The stronger party benefits from investing resources in conflict insofar as it is able to expand its dominion, tax base, or generally achieve more control over policy. The weaker party benefits from resisting the stronger insofar as it retains more power or property, or generally achieves a better policy result. The Nash equilibrium of this game involves a balance of power where both parties make intense efforts, e. g. engage in a power struggle.

Such investments in conflict are independently profitable in the sense that each party's own payoff increases as it invests more resources in the conflict (aggression for the stronger part/resistance for the weaker), other things being equal. However, the balance of power equilibrium that emerges is clearly wasteful in the sense that the welfare of both groups shrinks as additional resources are devoted to conflict. In the illustration, 8 units of resources can be said to be wasted at the Nash equilibrium [8 = (6+14) - (2+10)]. As in a conventional rent-seeking game, both parties would be better off if they could achieve the same balance of power while reducing the extent to which each invests resources in the conflict that originally generates that balance.

The use of a less resource intensive form of conflict via a well-designed "collective choice" mechanism is one way of reducing the losses associated with such conflict (Buchanan, 1975, or North, 1987). And it is clear that to the extent that all parties agree about the magnitude of the losses associated with violent conflict, they would all have an interest in designing a collective choice mechanism that could achieve a similar final apportionment of resources at lower cost.

Such an apportionment can be accomplished within the king and council template. The king and council template allows policymaking authority to be finely divided between the king and parliament in a manner which can replicate the payoff ratio's of nearly any violent equilibrium, while reducing the extent of the resources consumed by conflict. The extreme forms of political organization do not allow the possibility of such power sharing. Here, the bipolar template may emerge and be adjusted via explicit agreement—or quasi-constitutional contract—between the organized parties who would otherwise be engaged in relatively costly forms of conflict.[4]

This provides one explanation of power sharing between a more or less representative body (a parliament) and an executive (the king). The power struggle game also suggests that changes in the nature of that underlying equilibrium may cause the assignment of power between king and council to be revised if circumstances change, and it becomes clear that conflict between organized interest groups (the nobility, church authorities, guilds, major land holders, and laborers) and a hierarchical organization (king) would have generated a different equilibrium apportionment of power under the unabated power struggle game.[5]

However, it also explains the use of representative boards within smaller organizations and within families. In organizations that are not perfectly hierarchical, the decisions of the proprietor may be resisted at many levels of his or her

4 It bears noting that this setting departs somewhat from the initial position imagined by many contractarian theories of the state insofar as the parties to the new instrument of governance are not necessarily equal, nor are all affected parties necessarily consulted. Only a relatively small subset of the most powerful members of the polity are necessarily consulted regarding the new allocation of policymaking powers—essentially the parties to the original conflict.

Consequently, the resulting division of power may lack the normative appeal of the social contracts analyzed by Buchanan and Tullock (1962), Rawls (1971), or Buchanan (1975). However, such contracts none-the-less reduce the deadweight loss of governance, and also tend to make the political process more representative than would have been the case had the stronger party "simply" conquered the weaker.

5 An effective collective choice mechanism does not generally eliminate all losses from conflict, but reduces the cost of conflict by encouraging the use of more "civil" forms of social choice (Congleton, 1980). Persuasion and coalition building may replace warfare on the battle field, assassination and counter assassination, or tax avoidance may be replaced by tax compliance when less confiscatory tax instruments are used to raise revenue (Hobbes, 1959, Bush, 1972, and Buchanan, 1975).

organization. In such cases, rather than use the resources necessary to impose a decision, it is often sensible to use a decision making procedure that roughly replicates the expected result, but with lower decision costs. Even within small groups, such procedures increases information and, often, reduce the extent to which resources are wasted in conflict. In former times, when the oldest male was the undisputed leader of his family, a wise patriarch would clearly consult with his "council," his sons and perhaps adult woman, before reaching important family decisions.

5. Generality of the King and Council Template

At first reflection, the king and council template for governance may seem to have only a limited application. In early medieval Europe, councils and tings met to elect and advised the kings of Northern Europe. In late medieval Europe, many of Europe's kings formally established advisory councils and eventually parliaments that had significant control over public policy, for example, veto power over taxation, as in England and Sweden.[6] Some of these medieval parliaments continue into the present day in modified form.

However, bipolar governance within the king and council template is clearly more widespread than that of the ancient English and Swedish models. For example, many bipolar systems of governance were formally established by the social compacts and instruments of governance during the nineteenth century as new countries formed and as old nations reformed older political arrangements, as, for example, in Norway (1814), France (1814), Denmark (1849), Greece (1864), Italy (1861), Germany (1871), and Japan (1889). Moreover, essentially all modern democratic governments rely upon a structurally similar bipolar form of collective decision making with an executive branch (headed by a president or prime minister) and a legislative branch (a multi-member congress, assembly or parliament), each of which has significant policymaking responsibility.

A bit more reflection and investigation leads one to the conclusion that very few kings and dictators have lacked advisory councils of one kind or another, and very few democracies have lacked an executive branch headed by a single agent. Indeed, it appears that the bipolar "king and council" template for governance may be more commonplace than either of the better analyzed extremes. The bipolar king and council template is very scaleable, and is clearly widely used to make decisions within both public and private organizations. As a consequence, this bipolar template for collective choice is widely used in nonpolitical organizations as well: within firms (CEO and board of directors), within military organizations (commander and war council), and within the church (pope and congress of cardinals). Committee and executive decisionmaking procedures are also common place within local governments, universities and nonprofit organizations.

[6] It is difficult to pin point the date at which councils and tings evolved into parliaments. For example, the roots of the present English parliament extend back beyond the thirteenth century to the ancient Great Council (Magnum Concilium) which was composed of lay and ecclesiastical magnates. The Great Council met with the English King on affairs of the realm, including taxation. The Magna Charta of 1215 formally established an elected council of 25 barons to monitor and enforce the implementation of that 1215 compact between the English King, Church, and nobility.

Similarly the parliament of Sweden (the Riksdag) evolved out of the ancient Scandanavian and German institution of the Ting that had powers similar to the Great Council. *Tings* (ting, lagting or althing) combined aspects of modern judicial and legislative branches of government. Tings were deliberative assemblies that met at regular intervals to settle disputes, to pass sentences on law breakers, and to elect kings. A new formal Swedish council was established by law in 1319 at the time that Magnus Eriksson was elected king, in exchange for oathes of fealty by the great men of the realm. Council members had veto power over taxation and some policy decisions. The legal origin of the modern Swedish parliament (the Riksdag) is somewhat clearer than its historical development insofar as the Swedish parliament was formally established by the Riksdag Act of 1617. The latter, much modified, continues to the present day. See Petersson (1994: 6), Weibull (1993: 22), Holmberg and Stjernquist (1995: 12), or Congleton (2001, ch. 1,3).

The French Estates General also originated around 1300 at which time the King (Phillip the Fair) called representatives form the nobility, burgers, and clergy to form a grand council which was consulted for all major decisions. A smaller group composed of judges and lawyers, the "Parlement," was also consulted on a more regular basis. That group remained relatively influential throughout French history. Prior to the modern period, the various judiciary parlements served as the main check on the king's authority. The Estates General played a significant, but lessor role during the time prior to the French Revolution. See Bély (1998: 33, 58, 62, 75). Palmer and Colton (1965: 31) suggest that more or less similar representative institutions emerged throughout Europe during the 13th century. These assemblies were called variously Cortes in Spain, Diets in Germany, Estates-General in France, and Parliaments in the British Isles.

The use of bipolar governments clearly predates medieval Europe. Evidence of this is provided in Aristotle (1969) who discusses the merits of blended or mixed forms of government. See, for example, his Book 4 Chapter 12 or Book 5 Chapter 8 in his *Politics*. Aristotle's discussion is empirically based. His group engaged in an extensive analysis of the constitutions of Greek city states. Although most of that work has been lost, results from that study are evident throughout the *Politics*.

To say that in some of these organizations, the “councils” or the “executives” have only minor policymaking powers is, of course, correct. Consequently, considerable insight into the performance of nearly polar forms of “king and council” regimes can be obtained by analyzing the pure forms of collective choice (dictatorship and committees). On the other hand, to entirely neglect relatively weak branches of government, clearly understates their influence over policy. Even advisory councils must be listened to in a manner which impacts policies if serious advice is to be obtained. Similarly, appointed executive administrators often have control over policy relevant information and significant discretion over the implementation of directives from the legislature which gives them, at least implicitly, substantial influence over policy. (See Niskanen, 1969, Breton and Wintrobe, 1975.) Moreover, analysis of the extreme cases necessarily neglects the wide range of intermediate cases where significant policymaking power is vested in both parts of government.

As will be developed below, it is partly because the assignment of power between the “one-man” and “committee” branches of government can be varied so finely that the king and council is such a useful template. It allows a broad range of decisionmaking arrangements, a continuum, within which many bargains over power sharing can be negotiated.[7]

[7] It is clear that when constitutions are considered social compacts, bargaining power and original circumstances are likely to play an important role in constitutional design. For example, Buchanan and Tullock (1962) demonstrate that the particular collective choice mechanisms that will be agreed to will tend to vary with the particular choice setting in which the policymaking method will be applied. ™,Voigt (1999), extending Buchanan (1987), suggests that bargaining processes and bargaining power be taken seriously in institutional analysis. The analysis below demonstrates that a bargaining model of institutions together with a particular “template” for constitutional design can explain a good deal of constitutional history.