

EC411 L9:

Good Governance and Ethics

Chapters 2 through 5 of the book can be said to provide a theory of customary law—a theory of the emergence of productive informal rules that influence behavior in communities that lack written laws or formal law-enforcing institutions. Such rules are a subset of those promulgated by parents, friends, and village wise men and women. Most are internalized to varying degrees; thus, most members of a community follow those rules whether they are being watched by others or not, unless the temptations to violate them are too great.

Chapter 6 explores why law-enforcing organizations may be adopted by a community that has customary laws and the ethical dispositions that are necessary for such organizations to be “productive” in the sense that it contributes to the attractiveness of a community, rather than undermining it through extraction. A number of dilemmas have to be overcome for productive rule-enforcing organizations to emerge. Many of these are similar to those required for team production to be effective.

However, the aim of a good government (in the sense that that term is used in this book) is to advance the shared interests of the persons governed rather than those of the organization (the government) itself.

Governance and the Lockean Natural State

T]he community comes to be umpire, by settled standing rules, indifferent, and the same to all parties; and by men having authority from the community, for the execution of those rules, decides all the differences that may happen between any members of that society concerning any matter of right; and punishes those offences which any member hath committed against the society, with such penalties as the law has established: whereby it is easy to discern, who are, and who are not, in political society together. Those who are united into one body, and have a common established law and judicature to appeal to, with authority to decide controversies between them, and punish offenders, are in civil society one with another... —Locke, John (1690). *Two Treatises of Government* (p. 30). MacMay. Kindle Edition.

1. **A Lockean Point of Departure: The Simplest Form of Government**

- We begin our analysis of governing organizations in a community that has already emerged, which implies that informal rules have been internalized that address the most pressing problems of life with fellow humans.
- Many, if not most, parts of the systems of rules passed along have survived for decades if not centuries. A subset of the rules passed along have evolutionary support in that they made both communities and members of those communities more likely to survive in the environments in which they found themselves. They solved or ameliorated critical social dilemmas and make life in communities more attractive.
- However, although rule bound, individuals are not rule determined, the rules internalized must be interpreted and rule-innovation is possible at many margins of the rule systems internalized.

The Private Law Enforcement Dilemma

- Those violating community norms may be punished in various way. For example, they may be disparaged, may be excluded from other activities of direct individual value, may be shunned, or in extreme cases expelled from the community. **However, as the severity of punishments increase, punishments generally become more costly for individuals to impose on their own. This creates a free-rider problem regarding norm reinforcement, as illustrated in Table 6.1.**

As modelled, there is a single equilibrium with respect to rules that are costly to informally enforce, namely one in which all free ride, the rules are only weakly encouraged, and thus they are less likely to be strongly internalized.

This “enforcement dilemma” is normally ameliorated by higher-level norms that create duties to encourage adherence to the community’s rules and to mete out punishment to those who violate the rule of interest.

Table 6.1: The Private Law Enforcement Dilemma

		Richard		
		Always enforce rule	Enforce half the time	Never enforce
Gordon	Always enforce rule	(G, R) 5, 5	(G, R) 3, 6	(G, R) 1, 7
	Enforce half the time	6, 3	4, 4	2, 5
	Never enforce	7, 1	5, 2	3, 3

Potential Value of Governance in the Lockean Natural State

- **However, the encouragement provided by upper level norms that support the teaching and enforcement of a community's norms may be less than that required to fully inculcate their children with the most common and important rules** in their community and the other socially transmitted norms may be too weak to fully top up parental dispositions. **The more costly punishment is, the less likely it is that the rules internalized will resolve all significant social dilemmas.**

Such communities are in the Lockean state of nature. They have customary laws that essentially everyone is familiar with, but the laws are not always routinely followed by all members of the community. Rules that tend to discourage violence, theft, and excessive use of common resources are more than occasionally violated.

- **The undesirable consequences and causes of such rule violations tend to be obvious, and the rule-following members of a community may agree that life in their community could be made more attractive by creating a customary law-enforcing organization.**
- Such an organization would further encourage adherence to the community's most important rules by topping up the community's informal punishments with additional penalties for violating the rules.
- **A customary law-enforcing official or organization is arguably the simplest form of government possible.**
- Such an organization does not develop new laws, provide other public goods, or concern itself with public finance beyond that required to pay the salaries (if any) of the law enforcers. In small communities, it may be sufficient for a single man or woman to be granted authority to reinforce community norms with stronger external punishments.

Lockean Governance, the Potential Productivity of Well-Enforced Laws

- Unfortunately, it is no small task to assure that the communities enforcement agent(s) dutifully enforce its common laws.

The enforcement dilemma can be illustrated with the enforcement of any customary law. An

example that is linked to a community's prosperity is the enforcement of a community's anti-fraud norms.

Chapter 3 demonstrated that such norms that discourage fraudulent offers increase the scope of trade, facilitate specialization and thereby increase economic development.

Thus, diligent reinforcement of those norms by law enforcers would increase the prosperity of a community whenever anti-fraud norms were too weakly internalized by merchants to solve important fraud problems—e.g. if $v+g < 2$, and $v+F+g > 2$ (Note that there may still be two equilibria in this case.)

Table 6.2 Productivity of Well-Enforced Laws Against Fraud

		Richard (buyer)	
		Accept or solicit offer	Ignore all offers
Gary (seller)	Fraudulent offer	(G, R) (4 - g - F, -3)	(G, R) (-g - 1 - F, 0)
	Honest offer	(2 + v, 2)	(-1 + v, 0)
	Do not make offers	(0, -1)	(0, 0)

The Temptation(s) of Extractive Enforcement of Customary Laws

- **Unfortunately, there are “gains from trade” that can be realized by fraudsters and pragmatic law enforcers, although those defrauded are made worse off by such agreements.**
- A pragmatic seller can offer an amount up to the profits associated with fraudulent sales to the person(s) tasked with law enforcement (here, up to $3 - 2 = 2$, and $v = g = 0$ for the pragmatists). Pragmatic law enforcers would naturally bargain with the merchant and attempt to maximize his or her benefits from the exchange.
- **However, this does not imply that the equilibrium rate of bribery is 1 or that the probability of imposing a fine will normally be zero.**
- The profits of fraudsters and the bribes received by law enforcers are both affected by the probability of enforcement of anti-fraud laws and the magnitude of the profit sharing required to avoid enforcement.
- Profits from fraud fall to zero when anti-fraud laws are perfectly enforced (a probability of $F > 2$ of 100%). They also fall to zero when they are not enforced at all (a probability of 0%) because of the disappearance of markets in which fraudulent offers are commonplace.
- Thus, bribe receipts also fall to zero when the enforcement rates approach 100% or 0%. In between is a probability and sharing rule that maximizes the bribes received by enforcers.
- **The customary laws are partially enforced by pragmatists, but the result is a smaller economy than would have been the case if anti-fraud laws were fully enforced.**

The Temptation(s) of Extractive Enforcement of Anti-Corruption Laws

- **The law and economics solution to the problem of bribery is the creation of anti-corruption laws and an anti-corruption unit.** The community could create a two-tiered system of law enforcement in which the higher-level law enforcers (the anti-corruption unit) monitor the lower-level law enforcers that police the community. Anti-corruption laws in combination with appropriate fines could significantly reduce corruption in the anti-fraud enforcers and thereby reduce fraud in the community. **However, a moment's thought reveals that this is not likely to be the case if the new higher level of law enforcement is also staffed by pragmatists.** Pragmatic anti-corruption law enforcers would be inclined to “turn a blind eye” to bribery in exchange for some fraction of the profits realized by the anti-fraud police.

By sharing the bribe, both the anti-fraud and anti-corruption enforcers are enriched, and neither law is well enforced. Two equilibrium exist in this game, but the one that is mutually beneficial for both law enforcers tends to be weakly dominant.

(The assumption that the bribes are equally shared is used for illustration. Other sharing rule with shares between 0 and 1 would yield the same result. Gordon would adjust his share to maximize his income from bribery)

		Gordon (enforces anti-corruption law)	
		Enforce law	Accept bribe
Andrei (enforces anti-fraud law)	Enforces law	(A, G) S, S	(A, G) S, S
	Accepts bribe	S + B - F, S	S + B / 2, S + B / 2

Ethics as a Prerequisite for Good Governance

- **Under the Hobbesian conditions analyzed at the start of Part I, only pragmatists would exist, and corruption and extortion would be rampant in any government created.** Such regimes would be extractive rather than productive organizations.
- **Some improvement might take place over that associated with anarchy, although this is by no means guaranteed.** The enforcement of productive laws undertaken would be better than no enforcement; but the extraction undertaken via extortion could easily generate losses greater than the benefits realized by such law enforcement. **If extortion is commonplace, the result may be no better than that associated with the state of nature for all those outside government and its most important supporters.** Life would continue to be poor, nasty, brutish, and short—although it would no longer be solitary.
- **In the Lockean natural setting currently being explored, however, most persons in the community are not pragmatists.** They have internalized rules that create predispositions to abide by their community's customary laws when temptations to do otherwise are not “too great.” Insofar as internalization varies, some would resist more temptations than others would.
- **Law enforcement in such cases can be improved by recruiting enforcers from among the most law-abiding individuals in the community.** Such ethical law enforcers would resist taking bribes because they regard such action to be immoral or to violate their oaths of office and thereby induce guilty feelings.

Law Enforcement by Ethical Enforcers

When only a few such dutiful law enforcers are available, they should be employed in the anti-corruption agency rather than in the anti-fraud agency, because the enforcement of anti-corruption laws encourages pragmatists in the anti-fraud agency to resist taking bribes. Table 6.4 illustrates this case. **Strong internalized norms are most important for the officials with the most authority.**

In the case in which the lower-level enforcer is dutiful and the upper-level enforcer is a pragmatist, the anti-bribery laws may be enforced, but the upper-level enforcer will be unhappy with the idealistic behavior of anti-bribery enforcer. He would rather have a bit of extra income than have the anti-bribery laws perfectly enforced. Consequently, upper-level pragmatists would make life difficult for the honest anti-fraud enforcer. He or she might, for example, file unflattering reports or falsely accuse such agents of corruption. Insofar as the anti-corruption bureau plays a role in hiring, pragmatists at that agency will prefer to staff the anti-fraud agency with fellow pragmatists to profit from their “flexibility.”

Table 6.4 An Ethical Solution to the Enforcement Dilemma: Enforcing Laws Against Fraud and Bribery

		Gordon (enforces anti-bribery law)	
		Enforce Law	Accept Bribe
Andrei (enforces anti-fraud law)	Enforce law	(A, G) S, S+V	(A, G) S, S
	Accept bribe	S+B−F, S+V	S+B/2, S+B/2

Corruption in Large Organizations

- **The problem of corruption is not unique to governing organizations.** Similar logic applies to all large organizations. Every organization's internal rules need to be followed for it to be effective. It is such rules after all that transform a group of individuals into a team. Nonetheless the rules are never perfect nor perfectly enforced. All large organizations confront a variety of agency problems that have to be overcome if they are to advance organizational aims effectively, whether the aim is extraction, profits, votes, public service, or the welfare of the organization's most powerful officials. The temptations of individual employees to use their authority within an organization to promote their own interests rather than those of the organization or its formateurs are problems confronted by every organization. Such problems tend to increase with the size of an organization because more people have to be incentivized and monitored.
- **Nonetheless, agency problems tend to be more severe for governments than for other organizations.**
- First, the productivity of government employees and agencies is often more difficult to determine than employees in private organizations. eless, agency problems tend to be more severe for governments than for other organizations.
- Second, the agency problems of governments tend to have greater effects on persons who are not employees of government.
- Third, the latter effect implies that persons and organizations outside government have stronger incentives to attempt to bribe or otherwise persuade government officials to use their authority in a manner that narrowly benefits particular outsiders rather than to dispatch their duties to broadly benefit the community governed

Dealing with Corruption

- **Both firms and governments (even extractive ones) have good reason to try to reduce agency problems. It tends to increase profits for firm owners and net benefits for either rulers or voters according to the form of government.**
- Thus, ethical dispositions, as noted in chapters 3 and 4, tend to be one of the considerations when hiring government employees.
- Attempting to recruit persons likely to be “good team members” is important. **The more strongly the organization’s rules are internalized by their employees, the less monitoring and penalties are required to solve their agency problems.** This is especially true of hard-to-monitor agency problems such as those associated with corruption, extortion, and other abuses of authority.
- **Of course, encouraging employees to resist such temptations is not entirely left to moral dispositions.** Organizations all have their equivalents of the anti-fraud and anti-corruption agencies modelled in the previous sections. The above analysis implies that the normative dispositions of the persons charged with such tasks—foremen and managers—affect the effectiveness with which such internal enforcement is undertaken.
- **Keep in mind that it is not ethical conduct per se that ameliorates these problems, but a subset of the behavior induced by rules and principles of conduct regarded to be ethical. Not ethical principles reduce agency problems.**
- **Rewarding good governance.** With respect to enforcing a community’s or an organization’s own rules, persons with ethical dispositions that incline them to be diligent rule enforcers may be identified and rewarded with employment opportunities, higher salaries, and greater authority by governments.
- **By diligently enforcing “the law”, such persons tend to make their governments more productive and their communities more attractive by reducing a wide variety of political dilemmas.** For example, the honesty of accountants, purchasers, and senior managers tends to be an important qualification for their positions, and the persons occupying those positions are often very well paid.

Effects of Law Enforcement on Norms

Law Enforcement Encourages Stronger Internalization of the Rules Enforced

- After the agency problems for customary law enforcement have been solved, enforcement rates increase which increases adherence to a community's customary laws. **At this point, formal law enforcement may be said to “top up” the informal law enforcement provided by internalized normative dispositions and informal community sanctions. It is only in such cases that formal law enforcement and internalized ethical dispositions can be regarded as substitutes for each other.** In such cases, internalized norms, informal community sanctions, and law enforcement advance the same ends and induce the same kinds of behavior.
 - **Such law enforcement tends to further encourage the internalization of a community's ethos for reasons similar to those discussed regarding commercial rewards in chapters 3 and 4.** Government employment of persons with productive ethical dispositions increases the demand for and salaries of persons with what might be called “rule-following, rule-enforcing” dispositions. Such dutiful enforcers allow even very simple forms of government to avoid becoming extractive regimes. In addition, both the penalties imposed for violations of customary laws encourages investments the relevant dispositions by families and individuals. The routines associated with following the rule necessary to avoid legal penalties tend to become habitual, and so internalized by persons in the community—even among many who were not formerly rule followers.
 - For example, in many contemporary communities, most persons stop at a “no walk” signal even when the street is empty (and no one is looking) and wait for the light to change—rather than simply crossing because there is no traffic, and no one is looking.
 - **Faithful customary law enforcement thus tends to further stabilize patterns of life associated with a community's ethos, but it may also slow the process of social evolution by reducing opportunities for experimentation with alternative rules.**
- See Pinker (2012, Ch. 3) for a discussion of how changes in internalized rules reinforced by governments tended to reduce violence in Europe over the past several thousand years, and also for overviews of the anthropological literature on violence in days before written histories are available.

Customary Law Enforcement and the Emergence of Common Law

- When creating a customary law-enforcing organization, communities may direct their law enforcers to focus most of their efforts on violations of particular customary laws, rather than all of their customs. **Not all customs solve social dilemmas or solve coordination problems, and solutions to some social dilemmas are more important than others.**
- Such practical decisions are partly matters of ethics—which rules are most important—and partly matters of economics—how much time and energy should be devoted to law enforcement? Should formal law enforcement be a part-time or full-time job of one or more persons, and should there be one or more levels of law—laws for the community and laws for the law enforcers?
- Those choices, in turn, are influenced by the extent to which important customary laws are being violated—which, in turn, is determined by the strength of the weakest ethical dispositions in the community. If few or no important violations occur, formal law enforcement may not be helpful. If important violations are commonplace, then the advantages of formal law enforcement are substantial if agency problems can be overcome.
- **A consensus for creating and funding an enforcement agency requires agreement that significant problems exist, particular laws should be enforced, that particular resources should be used to fund the agency, and that better enforcement will significantly increase law-abiding behavior—and** thereby make life in the community more attractive.
- If formal law enforcement is expected to have little effect on behavior, then it is worthwhile only if it is very inexpensive. If it greatly reduces nonconformity with community norms, then greater expenditures on law enforcement are worthwhile.
- Such agreements are thus not automatic, but were, for example, commonplace in the early European colonial communities of North America.

Conclusions / thought questions

- The analysis of this chapter has provided an analytical narrative for the emergence of simple customary law–based governments. It is broadly consistent with the anthropological evidence on the origins of simple family-based and tribal governments developed by anthropological and archaeological research, a short summary of which is provided by Fukuyama (2011, Ch. 3). It has several implications about the nature of the earliest productive governments. First, governments (rule enforcing organizations) that emerge from community agreements tend to have duties that are grounded in the normative theories of the communities in which rules are to be enforced. Such customary laws differ somewhat from community to community because solutions to critical social dilemmas vary to some extent, although commonalities in the problems confronted imply that many similarities and overlaps in customary laws exist. Such variations and commonalities have long been noted by travelers, historians, anthropologists, and historians.
- Second, the extent to which laws are well enforced is largely a matter of the preexisting ethical dispositions of the person or persons granted law enforcing and law interpreting authority. The extent to which such persons, termed government officials here, perform their duties is substantially determined by their sense of obligation to do so. This sense of duty is most important at the upper levels of law enforcement—as in the courts and anti-corruption agencies—and tends to increase in important as law enforcing organizations (governments) increase in size and complexity. In the absence of such internalized duties, the laws will be unequally and corruptly applied. Rule enforcement by pragmatists, for example, tend to be extractive in that law enforcing authority is used to benefit members of government and their families, rather than the shared interests of the community governed.
- Third, when customary laws are well enforced, the result tends to be a more virtuous community, because well-enforced customary laws provide additional reasons for persons to follow and internalize the community’s rules. Abiding by their community’s customary laws reduces self-imposed guilt, socially imposed disapproval, and also avoids new formal punishments imposed by (or approved by) the law-enforcing system. Formal enforcement efforts thereby reinforce the habits of thought and action that produce dispositions to routinely make lawful decisions rather than ones that violate their community’s ethos.
- Fourth, a community’s customary laws are durable but not unchanging. As circumstances change and ethical innovations occur, a community’s norms change a bit—often incrementally but occasionally in significant ways. Thus, a community’s ideal enforcement agency should not endlessly enforce the same rules as if they were chiseled into stone, but should enforce rules that are customary at the time of enforcement. In the long run, customary law-enforcing agencies should adjust the scope and extent to which particular rules are subject to formal enforcement. To do so, standing procedures for adjusting the scope of governance may be adopted. They may take various forms: a wise leader, a council of elders, village meeting, juries, and so forth. Chapters 7 and 8 examine the importance of ethical dispositions in more complex and powerful governments.

Conclusions / thought questions

- (1) How well do you think that customary law enforcement worked in small communities? (Note this is different than saying that such communities followed the same norms as contemporary commercial societies do.)
- (2) Many stone age and somewhat later communities evidently had judges who would settle disputes rather than law enforcers as their first type of government. What does this imply about the difficulty of productive law enforcement or the productivity of customary law enforcement?
- (3) Modern police forces in cities emerged in the nineteenth century and were known for their corruption. Is this consistent with the models developed in this lecture/chapter?