

## Part II: Ethics and the Political Economy of Commerce

Had this [praise of virtue] been the universal strain, had you sought to persuade us of this from our youth upwards, we should not have been on the watch to keep one another from doing wrong, but **everyone would have been his own watchman**, because afraid, if he did wrong, of harbouring in himself the greatest of evils. [Plato. *The Republic* (p. 30). Kindle Edition.

[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.

### I. Introduction

Part I has demonstrated that ethical dispositions can in principle solve a wide variety of social dilemmas and can by themselves ameliorate a wide variety of social dilemmas—in fact they can in principle solve them all and produce well-functioning communities without governments. This possibility was mentioned by Spencer (1851) as the end of social evolution, but perfection of social norms is unnecessary for them to produce more attractive communities than could exist without them. Nor is it necessary that such rules affect every person’s behavior within a community for therapeutic consequences to emerge. Many of the choice settings associated with life in communities can be “factored” down into small subsets of the persons belonging to the community and if most of those subsets avoid conflict, address commons problems, provide local amenities, trade, produce, and specialize, communities will be more attractive than if few or no subsets of the community did so.

In Part II, the advantages of rule-enforcing and rule-making organizations are explored. In principle, as argued in many public economics textbooks, governmental policies can address all the dilemmas examined in part I. However, whether it can do so without its own supporting normative dispositions is less clear. Textbooks often implicitly assume that all the problems of good governance have been solved and so idealized legal and regulatory solutions can be adopted by governments. However, if this is the case, why are not the policies of all governments ideal?

Of course, the words “ideal” or “optimal” when applied to public policies are just alternative words for the policies of a “good society,” where as always the word “good” is open to a variety of interpretations. Ideal policies are not morally neutral, but implications of particular normative, ethical, or religious theories. In practice, most public economists adopt a utilitarian perspective and imagine an all-powerful government—the benevolent planner—whose only interest is to maximize social welfare (conceived in a utilitarian manner). Whether such a government would be regarded as good by anyone but utilitarian economists is debatable and a topic addressed in passing in Part II of the book.

The main focus of Part II is the extent to which productive as opposed to extractive states are even conceptually possible without the assumption that many of the persons working in government have internalized supportive ethical dispositions.

If ethical dispositions are required for good governance, then it cannot be argued that government policies and ethical disposition are substitutes for one another—as has been argued for more than three centuries. Rather, preexisting internalized ethical dispositions are also prerequisites for good government. After such governments are up and running, they may subsequently have effects on the distribution of a community’s ethical dispositions, but without supportive dispositions laws would neither be good nor well enforced.

Governments lacking such dispositions tend to be extractive and any services and laws that they enforce will be adopted with maximizing the rewards of those holding positions in government. “Good governments,” in contrast attempt to make it easier for their citizens to live a good life—as they themselves understand it—and therefore attempt to advance the shared interests of those living in the territory governed. Insofar as ethical dispositions have failed to solve all of the social dilemmas associated with life in communities, a good or productive government can make lives in communities more attractive than they would otherwise have been by addressing problems not (yet) solved by the community’s ethos.

Chapter 5 begins with the simplest possible notion of good government—as an organization that buttresses preexisting norms in the community of interest—a conception of government first developed by John Locke in 1690. Chapter 6 consider the role that ethics play when governments assume broader roles as when they adopt policies unrelated to social dilemmas, especially as these tend to affect the extent of commerce. Chapter 7 concludes part II with an analysis of the kinds of governing institutions that are likely to be selected by persons with ethical dispositions that are supportive of commerce and contrasts those with the institutional choices of persons with other dispositions.

## Chapter 5: Ethics, the Law, and Law Enforcement

These principalities are liable to danger when they are passing from the civil to the absolute order of government, for such princes either rule personally or through magistrates. **In the latter case, their government is weaker and more insecure, because it rests entirely on the goodwill of those citizens** who are raised to the magistracy, and who, especially in troubled times, can destroy the government with great ease, either by intrigue or open defiance. [Machiavelli, N. (1513/2015) *The Prince*. (Wisehouse Classics Edition) (KL 751–754)].

### I. Ethics and the Law

Part I can be said to provide a theory of customary law—of productive informal rules that largely govern behavior in communities without written laws or formal law-enforcing institutions. Such rules are promulgated by parents, friends, and village wise men. They may or may not have been written down. Many are internalized and such members of the community follow such rules whether they are being watched by others or not, unless the temptations to violate them are too large. Such rules and their associated feelings of virtue and guilt are part of the

“selves” and perceived self-interest of the persons that have internalized them.

Many of these internalized rules ameliorate the social dilemmas associated with life in communities. Others address problems associated with particular methods of production and distribution as with rules that characterize property, voluntary exchange, agreements between formeteurs and their team members. These may encourage, allow, or block some forms of exchange and the use of some new ideas and inventions.

No external rule enforcing organizations are required for reasonably attractive, stable, rule following communities to emerge and be sustained.

We now explore why formal laws and law-enforcing organizations may be adopted and the ethical dispositions that are necessary for such organizations to be “productive” and supportive of commerce. Some rule enforcing organizations may be adopted by those who want the rules enforced, others are formed because the rule enforcers expect to benefits from the rules created and enforced. Some governments adopt rules that support commerce, others that inhibit or block it from emerging.

There are a number of dilemmas that have to be overcome for governing organizations to emerge. Many of these are similar to those discussed under team production. Groups of men and women within

governing organizations have to induced to behave as teams—which is to say to effectively advance the interests of their organization. A “good” government’s interests are aligned with those of the community governed. An extractive government’s interests are aligned with those of the individuals holding the most powerful positions in that organization.

Part II is more concerned with the features of good governments than extractive ones, partly because relatively good governments were present in the countries in which commercial societies emerged in the nineteenth century, and partly because good governments are more obviously dependent on the ethical dispositions of their team members, leaders, and citizenry. Indeed, without supportive ethical dispositions all governments have a tendency to become extractive regimes.

## **II. A Lockian Point of Departure: Customary Law**

We begin our analysis of governing organizations from a position in which a community has already emerged, which implies that rules have emerged to address the most pressing problems of life in communities and largely been internalized by members of the group. These rules are regarded to have evolutionary support, in that they make both communities and members of the communities more likely to survive in the environment in which they find themselves.

The internalization of rules is not instantaneous, but largely the product of encouragement and practice that tend to produce habits of

thought and conduct—which may be augmented as a person matures by their own conclusions about good conduct and a good life.

A variety of punishments for violating rules of conduct are independently imposed by fellow members of a community. For example, those violating the norms may be disparaged, they may be excluded from other activities of direct individual value, they may be shunned or in extreme cases expelled from the community.

As the severity of punishments increases, punishments generally become more costly for individuals to impose on their own. This creates a free-rider problem regarding norm encouragement, as illustrated in table 5.1. At some point, there will be cases in which a productive rule requires significant organized enforcement to benefit from the rule of interest and/or decisions about what the appropriate punishment is for a

particular violation of the rules. For both reasons, some rules will be under or poorly enforced by members of the community.<sup>1</sup>

**Table 5.1: The Private Law Enforcement Dilemma**

		<b>Richard</b>		
		Always enforce rule	Enforce half the time	Never enforce
<b>Gordon</b>	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

Resolution of this “punishment dilemma” can be reduced by higher level norms that encourage dutiful punishment of those who violate the rule of interest, but when the private cost of punishments is high, these higher duties are unlikely to be sufficient to fully resolve the underenforcement problem.

If, life in a even a reasonably attractive community can be made more attractive by creating a law-enforcing organization. The advantages realized by general adherence to productive rules of conduct would

provide both collective support for such organizations and the additional resources required to enforce what may come to be regarded as “the law of the land.”

Such an organization need not be very complex when there are preexisting rules and norms that are simply to be enforced. A single man or woman may be granted authority to police the policing efforts of the community and encourage greater efforts, perhaps backed up by threats of targeted punishment for those who free ride. Such a local sheriff would serve at the pleasure of the community and would be removed when he or she fails to execute his or her duty tolerably well.

In small communities, it would be relatively easy to recognize the contributions made by such a person and also his or her derelictions of duty. In a larger community, monitoring by the community might be delegated to a committee of wisemen or wisewomen known to be more informed about such things than the average member of the community. In this manner, a relatively simply form of the “king and council” template might emerge and be productive for the community insofar as preexisting norms address most or all relevant social dilemmas, and

enhance group productivity enough to compensate for their additional costs. However, there is a limit beyond which this is no longer true.

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<sup>1</sup> Congleton and Vanberg (2001) demonstrate that a propensity to punish need not be a universal trait for it to be supported by survivorship. When punishment can be undertaken at a modest cost, persons who freely do so can

through improved enforcement, those rules of conduct are more uniformly followed.

Note, however, that the rule-enforcers cannot be indifferent to the rules nor to whether enforcement is fairly undertaken if the system is to work well. Rule enforcers may, for example, under police their friends and families and overly police and punish persons that they do not like or rivals for authority.

### III. On the Necessity of Ethical Dispositions in Law-Enforcing Organizations: Corruption and Favoritism in Law Enforcement

Consider, for example, the enforcement of anti-fraud laws. Such enforcement would be useful if norms in support of honest offers are too weak to solve all or most of the fraud problems confronted by buyers in local markets. Now suppose that law enforcers are “pragmatists,” which is to say persons who are largely uninhibited by the community’s ethos and so essentially indifferent about whether laws are enforced or not, but nonetheless tend to enforce laws because they enjoy having the power to do so and that power would be taken away from them by either the community or by its council of wisemen or wisewomen if customary

laws were never enforced or obviously improperly enforced. Assume that persons found guilty of fraud are fined.

Table 5.2 illustrates the effect of a fine on pragmatic sellers who would otherwise be inclined to make fraudulent offers. If the anticipated fine,  $F$ , is sufficient, pragmatic sellers will resist that temptation and make only honest offers. An expected fine that is greater than 1 is sufficient to do so. This is the traditional law and economics solution to crime.<sup>2</sup> In the absence of such enforcement, product markets in which fraud is relatively easy and profitable tend to disappear as their potential customers anticipate only fraudulent offers for such products, as noted in chapter 3.

**Table 5.2 Effect of Well-Enforced Laws Against Fraud**

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

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<sup>2</sup> Becker (1968), Tullock (1971), and Posner (1972) initiated the law and economics literature and provide useful introductions to the issues raised by rational choice models of law enforcement and criminal behavior.

Now assume that the persons enforcing the law are not themselves bound by ethics or other anticorruption laws and have the discretion to arrest the fraudulent seller or not, or to impose a fine on the fraudulent seller or not. Such discretion nearly always exists because judgement is always part of the law enforcement process. Knowing this, a pragmatic seller might offer to pay (bribe) the persons charged with enforcing the law to ignore his or her crime. A single seller who is able to avoid the antifraud law can profit by making fraudulent offers to unsuspecting sellers—who may believe that antifraud law is well enforced and thus reasonably conclude that only honest offers are made.<sup>3</sup>

In such cases, 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  $3-2=1$ ). The amount actually required depends on the law enforcer and the risks that he or she faces with respect to

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<sup>3</sup> In the case in which an ethical firm owner or employee confronts such a choice,  $G+F$  would be subtracted from the profits associated with fraudulent sales.  $F$  is formally the expected fine, which is less than the actual fine because the probability of being caught and convicted is less than one. The expected fine reflects a person's assessment of the probability of being caught and convicted,  $P$ , and the normal penalty,  $F^A$ , with  $F = PF^A$ . Of course, such fines are not the only solution to the problem of fraud as noted in chapter 3. A sufficiently large number of honest sellers can also solve this problem.

accepting bribes. If there is no risk and no guilt associated with accepting bribes, even a small bribe may suffice to blunt the effects of the antifraud law on pragmatic sellers.

If this is true of all law enforcers, all pragmatic sellers will pay small bribes, the antifraud laws will go unenforced, and commerce will fall to zero or near zero in markets populated only with pragmatic sellers where fraud is profitable, as developed in chapter 6. The mere creation of antifraud laws with significant fines and an organization tasked with enforcing that laws is not sufficient to solve the problem of fraud.<sup>4</sup> The laws must be faithfully enforced.

<sup>4</sup> Bribes tend to fall toward zero as the market disappeared, as with the Akerlof (1970) market for lemons. Knowledge that sellers would always “get off” would undermine such markets, except insofar as consumers can identify ethical sellers. This suggests that the optimal strategy for law enforces is to enforce the law in some cases, but not in all cases. In that case, a mixed strategy equilibrium would result and bribes would be collected and tolerated some fraction of the time, rather than all of the time. Nonetheless, although bribe income might be maximized in this way, the result would be smaller markets than in the case in which both antifraud and antibribery laws were both uniformly enforced. See, for example, Aidt (2003, 2009) for overview of the effects of corruption on economic development.

**A. Anti-Corruption Laws, Pragmatism, and the Extent of Corruption**

One possible method for reducing bribery is the adoption of anticorruption laws. That is to say, the law enforcing organization may also police its police. However, these higher-level laws must also be faithfully enforced to resist the propensities of pragmatists to accept bribes. A pragmatic anti-corruption law enforcer would be inclined to “turn a blind eye” in exchange for some fraction of the bribes receives by other law enforcers.

Table 5.3 illustrates a choice setting in which each law enforcer is paid salary  $S$  and the bribes are equally shared between the anti-fraud enforcer and the anti-corruption enforcer. The person (Andrei) charged with enforcing the antifraud law can receive a bribe of amount  $B$ , but would pay a fine of amount  $F$  if he does so and the antibribery law is enforced. Such anticorruption laws will bind Andrei if  $F > B$ .

**Table 5.3 The Enforcement Dilemma: Enforcing Laws Against Fraud and Bribery**

		Gordon (enforces anticorruption law)	
		Enforce law	Accept bribe
Andrei (enforces antifraud law)	Enforce law	(A, G) S, S	(A, G) S, S
	Accept bribe	S+B-F, S	S+B/2, S+B/2

However, the enforcer of the anticorruption laws (Gordon) may also be a pragmatist. By sharing the bribe, both pragmatic enforcers are enriched and neither law is enforced. A single equilibrium emerges in this game, one that is mutually beneficial for both law enforcers.<sup>5</sup>

There is no incentive for either law enforcer to propose or develop alternative institutions, in contrast to incentives associated with many social dilemmas. That is because the dilemma is external to the enforcement organization. The losers from the dereliction of duties are not the law enforcers or their organization, who are enriched by that

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<sup>5</sup> Hillman and Katz (1987) noted that such shared bribing arrangements tends to generate competition to obtain the positions through which such supplementary sources of income are received. They note that contests for such positions may dissipate the gains anticipated from those jobs, although it remains rational to stay in such contests rather than abandon the chance of receiving such “rents.” Insofar as such

investments are consumed through the process of achieving positions where rents can be received without producing anything new or useful, they can be regarded as wasteful. Such rent-seeking investments are thus another source of loss beyond those associated with poor law enforcement.

conduct, but those who benefit from law enforcement—here honest sellers and consumers.

Notice that this enforcement dilemma cannot be addressed by adding another level of law and law enforcement. The same logic would apply to efforts to enforce the anti-corruption laws when that is undertaken by pragmatists. Pragmatists only enforce the laws when doing so increases their effective salaries or otherwise advances their interests, which fully enforcing the law does not whenever bribery and similar types of trades are profitable and not easy to detect.

If any coordination takes place it is likely to be in the form that maximizes net revenues from bribery—which is to say to maximize the “extraction” associated with their positions of authority.

### **B. Ethical Dispositions and the Effectiveness of Law Enforcement**

When law enforcement is undertaken by pragmatists, the social dilemmas that laws and law enforcement are supposed to solve remain unaddressed, because uniform enforcement is not in the interest to those

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<sup>6</sup> Such a strategy does not necessarily require ethical positions at the top levels of government. As commerce falls so does tax revenue. If the senior officials’ income from tax revenues are larger than marginal increases in bribe revenues, an effort might be made to at least partially enforce antibribery laws as a method of increasing tax revenues. Antibribery laws would be enforced, but only to the point at which the

employed by enforcement agencies. The laws would be avoided by pragmatic sellers who are willing to pay enough to avoid punishment for fraud. The bribes would tend to be distributed among law enforcers. The distribution of bribe revenues within enforcing agencies might vary among corrupt organizations, although in general the upper levels of officialdom would attempt to maximize the bribe revenue extracted for themselves.

One possible solution to the corruption dilemma is the recruitment of law-abiding law enforcers. Such ethical law enforcers would resist taking bribes because they regard accepting bribes to be immoral and would feel guilty when doing so. This is especially important for senior officials. A senior official that supports the rule of law or opposes corruption for other reasons, would attempt to hire dutiful law enforcers for positions in the anticorruption and antibribery enforcement agencies and be inclined to punish those enforcers who violated anti-corruption laws and norms.<sup>6</sup>

A variety of ethical theories—although not all—may lead dutiful law enforcers to such conclusions. Agents that have promised to enforce

marginal increase in senior official income generated by increased national tax revenues equals their marginal reduction in bribery income. Corner solutions in which marginal tax revenue losses are always greater than marginal bribery gains would induce a pragmatic ruler to recruit anticorruption officials with strong ethical dispositions against bribery.

the law when they accepted their jobs and took oaths of office or signed papers may abide by their oaths because they have internalized a duty for keeping one's promises. Others may simply regard the law to be special and deemed worthy of support simply because it is "the law." Others might use more general normative theories, such as the ones proposed by utilitarians or contractarians in which law enforcement is the foundation of civil society, as argued for example by Hobbes and Mill.

When only a few such dutiful law enforcers are available, they should be employed in the anticorruption agency rather than in the antifraud agency. The enforcement of anticorruption laws encourages pragmatists in the antifraud agency to resist taking bribes. Table 9.6 illustrates this case.

**Table 5.4 An Ethical Solution to the Enforcement Dilemma: Enforcing Laws Against Fraud and Bribery**

		Gordon (enforces antibribery law)	
		Enforce Law	Accept Bribe
Andrei (enforces antifraud 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

In the case in which the antibribery enforcers regard the rewards of virtue to be greater than the temptation to share in the bribery, the antibribery laws would be enforced, which in turn can induce the

enforcement of antifraud laws. In table 5.4, this requires,  $V > B/2$  and  $F > B$ .

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

Of course, it would be better still to have ethical enforcers at both levels of law enforcement, because bribery is difficult to monitor, and anticorruption laws are therefore difficult to perfectly enforce by even the most virtuous and hardworking anticorruption agencies. In the absence of such dispositions at the most important nodes of government, extractive rather than productive enforcement of the laws is likely to be the norm rather than the exception.

#### IV. A Digression on the Severity of Agency Problems in Governance

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 profits, votes, public service, or the welfare of the organization's most powerful officials. The bribery problem discussed in the previous section is one of many such problems.<sup>7</sup> Shirking in all of its manifestations can be a problem at every level of every large organization.

Nonetheless, agency problems are arguably more severe for governments than for other organizations for two reasons. First, the productivity of government employees and agencies is often more difficult to assess than employees in private organizations. There is rarely an obvious index that can be used to assess the productivity of government employees or agencies in the manner that money profits and sales can be used for economic organizations. Private sector monitoring and measurement problems thus tend to be somewhat smaller, more objective, and so more manageable.

Second, the agency problems of governments tend to have greater effects on persons who are not employees of government. The policy

decisions of commercial organizations tend to affect only their employees, suppliers, and customers. The effects of malfeasance by senior government officials tend to negatively affect people throughout a given society.

Abuse of authority problems do not always affect the magnitude of an organization's output, but it may also affect the nature of the output produced, how and where it is produced, and how it is used. In private firms, a firm's "buyers" may purchase inputs from friends and family members or favor suppliers who provide "kickbacks" of various kinds, rather than purchase them from the least-cost or highest quality sources. Such abuses tend to increase production costs and somewhat reduce a firm's profits, although it may not affect total profits very much insofar as those favored profit. Similar abuses of authority in governments often involve larger contracts and so have larger effects on the distribution of profits among firms and income levels of government officials (through bribes and kickbacks). Subsidies may be targeted at particular persons or industries; some areas of tax law may be better enforced than others. Although the latter can advance general interest insofar as some areas or law are deemed more important than others, corruption can cause the

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<sup>7</sup> The corruption problem also exists in commercial enterprises. To the extent that various internal rules need to be enforced, bribery and other trading of favors may be used to pay off the rule enforcers. Thus, the

honesty of accountants, purchasers, and senior managers tends to be an important qualification for those positions.

allocation of enforcement efforts to advance narrow rather than general interests.

The temptation to misuse authority is often increased by tantalizing offers and persuasive arguments from groups outside the organization of interest. Customers and suppliers often lobby both governments and private firms for changes in the rules they enforce. Because the magnitude of government programs tends to be larger, the potential rewards and losses at stake tend to be greater than in dealings with private organizations.<sup>8</sup> As a consequence, greater efforts are undertaken, and the temptations confronted by government employees and agencies tend to be greater than for their private counterparts.<sup>9</sup>

Encouraging employees to resist such temptations when they run counter to organizational interests may be accomplished through an organization's conditional rewards (and punishments), but organizational rules are more likely to be more effective when organizations are staffed

by persons with ethical dispositions that either support organizational goals or resist undermining them. This is especially true of very hard-to-monitor agency problems such as those associated with corruption and abuse of authority.

It bears keeping in mind that it is only a subset of ethical dispositions that increase the effectiveness of organizations—including governments—rather than ethical conduct in general. Some maxims and ethical principles no implications for behavior in organizations. Indeed, some norms may reinforce rather than counter problems such as corruption and shirking.

Insofar as persons with useful ethical dispositions can be identified, those persons will be rewarded with employment opportunities, higher salary, and greater authority in government agencies that are more effective because of their efforts to recruit and retain such officials.

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<sup>8</sup> There are, of course, exceptions to this generalization. The temptations faced by senior managers of international corporations clearly exceed those of junior managers and teachers of state and local governments and may rival those of officials from national governments. Nonetheless, within most territories and at most times, the largest source of rules, the largest employer, and the organizations spending the most money are governments. For example, Google employees approximately 72,000 persons, whereas the State of California has more than 500,000 employees. Denmark, a relatively small nation state, has on the order of 750,000 public sector employees, about ten times the employees of

Google. Google's annual revenues are less than \$80 billion per year, whereas the tax revenue of California is well over \$100 billion. That of Denmark is over \$150 billion per year.

<sup>9</sup> There is a large game theoretic literature that shows how the “prizes” at stake affect investment in efforts to influence those with the authority to hand out the prize. See Garfinkel and Skaperdas (2008) or Konrad (2009) for overviews of contest theory. See Congleton and Hillman (2015) or Congleton, Hillman, and Konrad (2008) for overviews of the rent-seeking and rent-extraction literatures.

## V. “Good” Customary Law Enforcement Enhances a Community’s Ethos

After the agency problem for customary law enforcement has been solved, everyone follows the norms within the community—if we ignore the problem of detection of violations, which in small communities tends to be less than in large ones. In this setting, formal law enforcement “tops up” the informal law enforcement provided by internalized normative dispositions and informal community sanctions. In this setting, formal law enforcement and internalized ethical dispositions are truly substitutes for each other. They advance exactly the same ends and induce exactly the same behavior—again ignoring detection problems.

That customary law is well enforced does not necessarily imply that there is equality before the law because “good” people who have largely internalized the community’s rules can be encouraged to follow the community’s rules with smaller penalties than “bad” people, who have not. But, it does imply that discretion over penalties is not abused and used as an extractive strategy rather than to solve pre-existing social dilemmas.

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<sup>10</sup> See Congleton and Vanberg (2001) for evidence that such “enforcer” dispositions may emerge and be viable in a settings in which prisoner dilemma like settings exist and individuals are free to exit from disfunctional small groups. They demonstrate that persons with the

Just as an increase in commerce alters the distribution of internalized ethical dispositions in a community, well-enforced customary law does so as well. It does so in two ways. First, it increases the demand for persons with what might called “rule-following rule-enforcement” dispositions. These are persons for whom the law (here customary law) is important in its own right and enforcing it an important internalized duty. It is such dutiful enforcers that allow this simple form of government to avoid becoming an extractive regime. To the extent that systematic efforts are undertake not find and employ such enforcers, their salaries and status tends to increase within the community, which tends to encourage investments in such predispositions by families who want such opportunities for their children and individuals seeking such positions. This is analogous to the effect of markets on ethical dispositions discussed in chapter 3.<sup>10</sup>

A second effect is to broadly encourage the development of all ethical dispositions. If informal support for transmitting ethical ideas and encouraging the development of ethical dispositions are unchanged by formal customary law enforcement, law enforcement simply adds to the support for such dispositions. Those lacking sufficiently strong

ability to target punishments at persons who engaged in uncooperative behavior tends to improve team performance enough that such dispositions are evolutionarily supported even if there are non-trivial costs associated with imposing penalties on “shirkers.”

ethical dispositions are subject to fines and other punishments that those who do avoid. The formal enforcement regime also tends to reduce the effects of free riding on the process encouraging the formation of such ethical dispositions. Thus, “good” formal enforcement of customary laws grounded in ethical dispositions tends to reinforce those dispositions.

The result, of course, varies with the extent to which appropriate “good” law enforcers are available and the extent to which free riding with respect to inculcating the community’s ethos takes place. The less perfect enforcement is and the less free riding of this sort occurs, the smaller this enhanced virtue effect tends to be. Such communities will require little active law enforcement in practice, although the threat of punishment is what generates this virtuous effect.

## **VI. Customary Law Enforcement and the Emergence of Common Law**

This chapter focuses on communities that have already developed rules of conduct that are at least partially internalized by most persons in the community of interest. Such communities will have ameliorated the most important social dilemmas and established useful conventions of various sorts. There are rules that most people in the community follow most or at least much of the time. Such communities have moved from Hobbesian anarchy, but to a state of development short of Spencer’s utopian anarchy. At such a point in social development, the creation of a

customary law enforcing organization can potentially make life within such communities more attractive.

However, doing so requires finding and employing persons with ethical dispositions that tend to support the law-enforcement enterprise. Unless the persons given the authority to punish those violating customary laws dutifully do so, the most likely result would be an extractive organization that uses that authority to benefit from bribery and extortion. Such a regime would make a community less attractive rather than more attractive, but might be difficult to dispose of once created—because the enforcers are organized and good at producing threats that discourage disbanding the organization.

Once such persons are identified—at least for the most important positions—such an organization can make life in communities more attractive than it would otherwise be. The customary laws are more diligently followed, which for the subset of those laws that ameliorate social dilemmas implies less problematic equilibria to those choice settings. And, to the extent that conventions reduce coordination problems, such problems would also be diminished. Moreover, the extent to which a community’s ethos is widely and strongly internalized tends to increase. All these effects tend to make a community more attractive. A minimalist government that diligently enforces customary law tends to yield significant benefits for communities that are likely to be greater than

their costs. And these benefits tend to be larger the farther a society is from the Spencerian ideal.

One possible problem with customary law enforcement is that it tends to be conservative in the sense that it reinforces existing norms and tends to discourage the refinement of such norms and the replacement of those norms with others. Most refinements and experiments with new norms are, after all, violations of customary laws. They are deviations from a community's existing ethos.

One can imagine that a customary law regime that tolerates minor transgressions might be generally preferred to one that applies a very narrow interpretation of customary laws whenever there is significant disagreement about the exact rules of conduct that are proper. In such cases, a bit of experimentation would be tolerated and as the center of the distribution of customary law shifts through time, customary law enforcement would also shift. In effect, such a regime becomes a common law regime rather than a customary law regime. It adapts to changes in the community's norm that emerge through time.

## VII. Conclusions

The analysis of this chapter has several implications concerning the earliest formal laws and productive governments. First, many of the laws in place are likely to be grounded in the normative theories of the communities in which the laws apply. This is most clearly the case for customary and common law in which laws emerge more or less directly from durable norms and patterns of behavior in the communities of interest. It is less true of statutory laws in extractive regimes, but even such regimes will respect community norms in areas in which they do not undermine a ruler or ruling group's ability to retain authority. Such morally grounded laws will differ from community to community insofar as normative theories and their associated dispositions differ among communities.

Second, the extent to which laws are well-enforced is partly a matter of preexisting ethical dispositions, especially among the government agents and agencies with responsibilities for law enforcement. This is not to say that the rules actually enforced necessarily reflect the ethical theories internalized by persons employed by in formal law enforcing organizations, but that whether those agents adhere to the letter of the law is partly determined by their sense of duty to do so. This sense of duty is most important at the upper levels of law enforcement—as in the courts and anticorruption agencies—but tends to be important throughout the enforcement agencies insofar as corruption is difficult to monitor and discourage through external incentive systems. In the

absence of such internalization of duties, the laws will be unequally and corruptly applied, likely to conflict with community norms regarding justice and undermine economic development, and the law enforcing organization is more likely to be extractive—another problem to deal with—rather than a productive organization that reinforces solutions to the dilemmas associated with life in communities.

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 develop ethical dispositions. Members of the community will not only avoid self-imposed guilt and socially imposed disapproval and chiding, they will also avoid formal punishments imposed by their law enforcing organization, which is to say their government.

All this demonstrates that ethical dispositions play a number of important roles in even the simplest governments imaginable. Although such organizations can improve societies as argued by Thomas Hobbes and his fellow travelers, they do so by reinforcing preexisting norms. They do not have to invent laws and governing procedures whole cloth, because most of the laws and many of the procedures had emerged in earlier times to solve social dilemmas without which the communities would not exist. Moreover without such ethical dispositions, effective productive governments are not likely.

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