

Chapter 4: Territorial Governance: Monopoly Power, Exit, and Coercive Rule

Two meanings of the term government are common in English. One refers to the decisionmaking or policymaking part of a formal organization. Every club, nonprofit organization, and firm has a government in this sense, as noted in the previous two chapters. These policymaking bodies impose rules on their team members to solve team production problems and to direct an organization's resources to advance specific purposes. The other meaning refers to the subset of organizations that have extensive ability to impose rules on persons outside their organization within a particular geographical territory.

In this respect, territorial governments may be said to differ in degree, not in kind, from other organizations. Other organizations can also impose rules of outsiders, but to a much more limited degree. In most other respects, however, territorial governments are fundamentally similar to other organizations, as noted above. Each has to solve decisionmaking and team production problems, and each has to generate sufficient resources to be self-sustaining. Each tends to advance the goals of their formateurs and successor governments, and none can neglect the interests of their team members.

The theory of territorial governance developed in this chapter draws from productive theories of the state, as in the work of Nozick (1974), Montesquieu (1748), and Aristotle (350 BCE). The theory differs, however, from that of Hobbes (1651) and most social contract and revolutionary theories of governance by stressing the gradual emergence of territorial governments from a multiplicity of organizations, rather than a sudden shift from anarchy to statehood. It seems clear that a war of "every man against every other" would not last very long in practice, because teams would quickly be organized by formateurs for purposes of defense (and aggression), as noted by

Montesquieu. These voluntary organizations are not be states in the sense used here, because they would only be able to impose rules on persons outside their organizations. Moreover, such anarchy-based theories of the state cannot really explain how civil societies emerge. This requires some plausible theory of transition from the low-income traps of warrior-clan societies locked in endless battles.²⁸ Peace treaties are notoriously difficult to negotiate and enforce. Civil society is more likely to emerge if conflict is limited rather than all-encompassing, and if places of relative tranquility exist.

This chapter provides an alternative explanation of the emergence of territorial organizations with the ability to impose rules on residents of "their" territories. It demonstrates that monopoly power over critical services can enable an organization to impose rules on persons outside their organizations and that their ability to do so is constrained by the mobility of the persons "ruled." The latter implies that rule-imposing organizations are unlikely to become powerful rule-imposing sovereigns unless the results are better for both their team members and their communities than available elsewhere. This is not to say that military power and its associated conflict are irrelevant, but it is to say that they are unlikely to be the main explanation for the emergence of territorial governance

Both the approach and conclusions of this chapter are broadly consistent with the historical analyses of Spruyt (1994) and Ertman (1997), who stress that nation-states emerged in the fifteenth, sixteenth, and seventeenth centuries as one of many organizational types through various coercive and noncoercive forms of competition.

I. A Digression on Rule by "Strong Men"

Brute force theories of the state often begin with discussions of "pecking orders," common in many animal groups, in which the biggest, strongest animal gains privileged access to food and females. By analogy, it is often argued that in early human societies, a

²⁸ See, Tullock (1972) for an early collection of rational choice-based analysis of the emergence of the state from anarchy. Nozick (1974) includes an analytical theory of the state that has many parallels with that developed in this chapter. Oye (1986), Garfinkel and Skaperdas (1996), and Stringham (2006) provide more recent collections. See Konrad and Skaperdas (2005) for a game theoretic treatment of "protection services" and the emergence of coercive states in a setting without exit possibilities.

strong man simply used his brute strength to dominate a group and profited by “taxing” other group members who “paid up” to avoid being attacked. Such theories often note that the first human organization, the nuclear family, is often dominated by such strong men for decades at a time. The patriarch is often the physically strongest member of that group.

In larger groups, the physically strongest man may simply be a better formeteur than others, because he can solve many internal enforcement problems directly by threatening to harm the persons of shirking team members. Such forceful leadership is evident in the mythic histories of famous kings in the past, from Odysseus to Arthur.

The critical weakness of the brute force theories of the state is that organizational talent and physical strength are not necessarily correlated with each other. Thus, in many cases, it would be possible for the second and third strongest members of a group to organize a team of two or three and defeat the strongest man. Even a very strong man needs to sleep. Consequently, if the second strongest man is a better organizer than the first, he will tend to emerge as the community’s “strong man,” as might the third or fourth strongest, and so forth. Physical strength is not of central importance for leadership posts in large organizations, even in cases in which the organization is largely based on the ability to make credible coercive threats. Napoleon and Hitler were not unusually tall or strong men, although they both ran powerful coercive organizations.

Once standing organizations emerge, the “strong man” is simply the pivotal decisionmaker within his or her organization’s government.

II. Coercive Governance and Exit Costs

Organizational talent, however, is not sufficient by itself to produce an organization that can impose rules on outsiders. Very large successful organizations are often created by energetic formeteurs, such as Henry Ford, Kiichiro Toyota, Thomas Edison, Friedrich Krup, Henry Dunant, Clara Barton, and the like, but in the modern context, such talented formeteurs are not able to impose many rules on many people outside their own

organizations. Henry Ford once attempted to reduce his production costs by imposing a particular color on his customers at the height of his monopoly power. Ford’s customers could purchase his automobiles in “any color they want, as long as it is black.” Many of his potential customers preferred other colors and chose instead automobiles produced by his less demanding rivals, and Ford’s monopoly power quickly disappeared.

In a setting of low exit costs and attractive alternatives, attempts to impose arbitrary rules tend to induce exit, rather than compliance, unless the overall rewards of continued association are sufficiently attractive. It is for this reason that a pirate ship captain can use far more severe penalties—denial of food and water or accommodation on the ship itself—while at sea than in port. Unless the bounty is plenty, a harshly sanctioned crew will depart for other ships once a port is reached. The use of coercion (penalties) to punish noncompliant behavior within a community is further limited by difficulties in targeting sanctions.

Minimum Acceptable Rewards

Members of an existing community have essentially three possible responses to demands made on them by their government: they can comply, not comply, or leave the territory in which that organization attempts to impose and enforce its rules.

The essential arithmetic of making and accepting such demands is represented in Table 4.1. The community member receives benefit R if he or she complies with the demand, receives B if he or she does not comply, but is sanctioned by amount P , and realizes $A - E$ if he or she chooses to leave the community, where A is the expected net benefits from membership in another organization and E is the member’s exit cost. It is sensible for the government to make such proposals (i.e., please do D) as long as organizational surplus will be increased by the member’s compliance ($\Pi - R > C$). A member accepts their government’s demand (does D) as long as the reward from doing is greater than the alternatives of noncompliance and exit, $R > B - P$ and $R > A - E$. In perfectly ruled polities, R is always greater than $B - P$ and community members always follow the rules.

Table 4.1:
Coercive Enforcement of Rules

	Formeteur	Member
Community member accepts the organization's demand.	$\Pi - R$	R
Community member rejects the organization's demand.	C	B-P
Former community member Emmigrates.	C	A-E

The minimum acceptable reward for membership, however, is also affected by exit costs and the value of alternatives beyond the governing organization's control. The minimum acceptable reward clearly increases as the net value of opportunities outside the organization increases and as exit costs decline, other things being equal. In a setting in which it is quite easy to move among organizations, each governing organization will have to provide net rewards to their community members that equal or exceed those available outside the organization, net of exit costs. R must exceed both B-P and A-E.

Moreover, it bears noting that rewards tend to differ within the community. An individual member's productivity affects both the organization's ability to offer rewards and interest in retaining that members. The organization cannot afford to make offers such that $\Pi - R < C$. And, insofar as the exit costs of two equally productive persons differ, variations in exit costs affect the minimum reward that is able to retain particular persons. Consequently, unusually productive members who could easily move to other

organizations will be more carefully treated (subject to less arbitrary punishment) and receive higher rewards for their efforts. A wealthy merchant may be subject to different rule than a wealth farmer. Ruleful enforcement systems tend to make retention of community members easier, but equal protection law may not.

In cases in which it is not easy to exit and rejoin the a given community, the calculus of remaining a resident will be based on the long-term average (expected) net benefits of continued affiliation. In such cases, community members will accept a bit of arbitrary punishment from their governing organizations whenever exit costs exist, even if the alternatives outside the community are somewhat better than those associated with their own organization. A may be greater than R, but R may on average be greater than A-E.²⁹

Community members, however, will not accept any and all punishments that come their way as long as exit is possible. Organizations that are prone to impose penalties on the wrong person and those that have relatively severe penalties tend to provide lower risk-adjusted net benefits than otherwise similar ruling organizations with smaller errors or less severe punishments. Attempts to impose and enforce arbitrary rules on persons living within a given community might well cause the community to disintegrate as those disadvantaged quietly depart for other locations where taxes (and punishments) are less common, less arbitrary, or less harsh, or the public services are higher.³⁰ In such cases, arbitrary punishment induces members to "abandon ship."

Exit Costs and Exit Control

It bears noting however, that exit costs are not simply the minimum physical and emotional costs of relocating, but often partly determined by a government's policies. Organizations that can increase the cost of exit for their members and residents can

²⁹ If punishments were always precisely targeted at shirking individuals and individuals never shirked by accident, only those most inclined to shirk would leave as punishments became more severe. In such cases, exit tends to make the organization more effective and even more attractive for "work-oriented" team and community members.

³⁰ Congleton and Vanberg (2001) show that the ability to target punishments at shirkers can be sufficiently important to the success of joint enterprises that norms may emerge so that other team members will punish shirkers, even if personally costly. Team members will often have better information about who is shirking and thus be better able to target penalties at those "not carrying their load." Such norms, however, are not always sufficient to solve the problems that must be addressed and that active management in this sense is necessary to solve team production problems.

reduce the rewards that necessary to retain existing members, albeit at the risk of attracting fewer immigrants.

Exit costs can be increased, for example, by punishing “defection” with exit fees of various kinds. The ruling organization may attempt to damage the departing member’s reputation by declaring that the person leaving “is a shirker,” “has never done his duties,” “has violated our trust,” “is a thief,” and so on. In such cases, it will be difficult for outsiders to judge whether a particular departure is a “voluntary exit” from a dysfunctional community or the “banishment” of a person or group for poor performance. Other organizations, whether governments or not, can only imperfectly distinguish between potentially productive and nonproductive new members.³¹ And, they will naturally hesitate to include shirkers from other teams on their own teams.³² Similarly, future members, may assume that such departures are banishments, rather than exits, and not take them into account when joining the organization.³³

Because of these and other factors, exit costs are rarely trivial, and limited use of coercive proposals to address team production problems in the community at large is often possible. “Do D or you will be punished with P” is a common experience for most members of most organizations and communities.

III. Territorial Monopoly as a Foundation for Territorial Governance

A ruling organization’s ability to impose rules on “outsiders” and “insiders” makes the boundary between the insiders and outsiders less than perfectly sharp in practice, although that distinction is a useful one for many purposes. For example, a commercial organization’s “customers” are not “insiders” in the sense used above, because they do not ordinarily participate in the firm’s team production, but they are nonetheless loosely affiliated with the organization and affect the organization’s viability. Similar associations exist for a church’s congregation, the victims served by charitable organizations, and the alumni of colleges and similar organizations.³⁴

Organizations can often impose rules on such affiliated persons, although within limits, as noted above. In a setting in which customers may acquire the same services from a variety of organizations, their exit costs are low and the value of alternative sources of the services of interest are essentially equal. In such cases, no organization can demand a higher price for its services than any other, whether in cash or kind. However, in cases in which an organization provides an important, essentially unique service, a much higher price can be charged, that may well include cash and services to the firm. In such cases, customers must pay “the price” or do without.

Monopoly power potentially allows organizations to collect high fees, but also to impose rules and duties on their customers in exchange for the services provided. Here,

³¹ Because of this, many organizations are very difficult to join, which tends to reduce prospects for exit. It is, for example, difficult to move between relation-based groups such as families and clans. Such groups may, consequently, use punishments (spanking, etc.) more readily than more open groups such as bowling associations.

³² The reputation problem can be reduced, somewhat, by staying on the job or in a particular community until an exit alternative is found, but such on-the-job searching can be difficult to undertake and often places internal good will at risk.

³³ If punishments are not perfectly targeted, the net rewards associated with a given effort by A, B, or C will be random variables that are only partially conditioned on behavior. If utility functions are concave, which is sufficient to characterize risk-averse behavior, expected utility tends to fall as the variance increases, other things being equal. If the expected net benefits in community A are the same as those in B, but A uses harsher punishments than B, even a small error in assigning severe punishments for shirking can induce exit by risk-averse residents. Even greater exit is predicted by many of the asymmetric theories of behavior under uncertainty, if avoiding possible losses is considered to be more important than obtaining possible gains.

³⁴ Note that liberal notions of government that emerged during the enlightenment further blur this distinction. The ideas of popular sovereignty and social contracts, in effect, make the entire community the “true” formateurs of the governing organization, and thus an essential member of government. Although there are a few cases in which this metaphor is literally true, historically most governing organizations have had distinct insiders and outsiders. Such distinctions are easy to make in king-dominated forms of king and council governments, but are often routinely applied to modern democratic governments as well.

one can imagine a water monopoly that controls the local irrigation network. If a farmer wishes to have food on the table next year, he must have a reliable source of water and so is willing to pay a high price to the local water monopoly. If prices become too high, the farmer may sell his land and move, although prices would have to be very high to induce abandonment of fertile farmland. In such cases, the quality and extent of available substitutes plays a role that is very similar to exit costs.

It bears noting that a monopoly price may involve more than a simply transfer money from customers to the organization's treasury. A monopolist that controls an important service is often able to earn additional profits by multi-part prices that require both money and services from their customers. For example, a water monopolist might set its prices in terms of money, farm output, hours of work, and deference to the organization's leadership. Such complex pricing can generate significant improvements in the well-being of the water monopolist over cash payments alone, because well-developed markets for other resources may not exist, or because some customer resources are worth more to the monopolist than to other organizations. Deference, for example, is not a tradable good. A farmer would not pay exorbitant prices for unimportant services, but some services are worth more their weight in gold.

There are many important services that can be monopolized by organizations in an insecure world without extensive trading networks. For example, suppose that a "protective wall cooperative" builds a protective wall around a plot of ground outside an existing village or a community that is available only to its members (subscribers). This coop is clearly able to demand high membership fees in settings where external security risks are high and no other redoubts are available nearby. It can also raise membership dues at times of unusually high risk. Indeed, at such times, potential members may be willing to pay essentially any price to join the club. The implied offer is essentially "your money or your life," although in this case, the coop clearly offers a service, rather than a threat. However, the fact that the threat comes from "roving bandits" does not diminish the club's bargaining power or its ability to impose rules on members and potential

members. In insecure times, the membership dues of such clubs can be as high as the wall is secure. Monopoly power over a valuable service allows the organization to impose both high fees (taxes) and demanding rules on those who hope to gain access to the service.

By controlling the magnitude and mix of payments required for access to its services, the governing body of organizations with monopolies over important services within a geographic area can exercise significant control over all who live there.

Note that the ability of an organization to impose rules in such cases arises not through the exercise of military power (although some police power may be necessary to protect their claims to the irrigation network or wall), but rather through their ability to deny access to extremely valuable services. If a person fails to pay, he or she might face starvation in the future or be banished from a redoubt or walled community, increasing their risks from roving bandits in both the short and long run. Moreover, more than one organization may be able to impose rules on outsiders in a given territory.

The ability of organizations to impose rules on outsiders clearly varies with their monopoly power. Even firms in competitive markets often impose rules on their customers; for example, a grocery store will exclude unruly customers who impose negative externalities on other customers or significantly increase a firm's production costs by disturbing the arrangement of inventory on shelves or other displays. Such rules for customers, however, can be imposed only if they directly or indirectly benefit their customers. For example, shopping rules often allow firms to provide their services at lower costs to the customers. Dress codes may create ambiance desired by a restaurant's customers. Ease of substitution (exit), however, clearly limits the ability of rival organizations to impose rules on their customers. McDonalds, for example, could not require all of its customers to wear tuxedos. Coercive proposals do not always yield additional net benefits for organizations or their customers.

The possibility of exit and substitution constrains every organization's use of coercive demands and arbitrary penalties to secure control over resources. The stay-go decision calculus is very similar to that illustrated above in table 4.1. Risk aversion implies

that individuals, families, and other organizations will remain resident-customers in the communities serviced by particular organizations only if the overall net rewards, adjusted for risk, are higher than those available in other communities net of exit costs. If the risk-adjusted expected net returns in community M fall below those available at community N, people and their resources will move from community M to community N. Both the “arbitrariness” of rule enforcement (error rate) and the severity of the punishments associated with violating the rules are constrained by the possibility of exit.

Consequently, a territorial government can increase its ability to impose rules by providing a better mix of community services than available elsewhere, by increasing exit costs, and by reducing the attractiveness of communities outside its territory. However, it bears noting that more than one organization may have the ability to impose rules within a given territory at the same time. There may be different levels of government, more than one critical monopolists, and organizations, such as churches, that are explicitly valued for their rule-making services.

IV. Encompassing Interests, Monopoly Power, and the Rule of Law

Economics implies that regional monopolists have incentives to increase the demand for their services through every method that can increase their organizational surplus. Monopoly power can be increased by reducing the availability of substitutes and increasing exit costs, which tends to make community members worse off. It may also be increased by monopolizing several critical services. A dominant organization may monopolize, for example, various combinations of defensive services, transport and irrigation networks, and religion. Such steps tend to make community members worse off by shifting the terms of exchange in favor of the ruling organization.

However, in addition to strengthening the organization’s monopoly power, the demand for its services can often be increased by increasing local income, which tends to make residents better off. The latter gives regional governments what Olson terms an

“encompassing interest” in their communities’ welfare and can lead regional monopolists to provide a variety of public services unconnected to its monopoly power. Any public service that directly or indirectly increases revenues for the monopolist by more than it costs may be provided. For example, a local monopolist may undertake or subsidize the construction of a network of connecting roads in order to increase income throughout the community and thereby also increase effective demand for the monopoly services.

Similarly, a regional monopolist may provide dispute resolution and other legal services because “law and order” increases prosperity and the demand for its services. “Law and order” tends to increase the demand for all normal goods. Dispute resolution services can be provided at a relatively low cost by monopolists of important services, because compliance with its “rulings” can be assured by simply threatening to deny services to those who fail to heed its decisions. However, providing such services may make good sense for a dominant organization even if fees for such service are below the cost of providing them.

Just as a consistent predictable set of rules can increase an organization’s viability by solving coordination and team production problems, so can a predictable set of rules increase the prosperity of a community. A stable set of rules facilitates long-term planning by individuals and organizations, increases investment, allows resources to shift from lower to higher valued uses, reduces the cost of unproductive conflict among persons and organizations, and tends to produce more stable communities by reducing risks associated with arbitrary treatment by ruling authorities. The “value added” by such services is noted in the early enlightenment contract theories of the state developed by Hobbes (1651) and Locke (1689) and also in contemporary game theoretic explorations of shifts from anarchy to civil society, as in Nozick (1974), Skogh (1982), and Volckart (2000).³⁵

In such cases, a monopolist may create a new “division” within his or her organization to provide dispute resolution services. Consistency can be assured by writing down the rules and reinforced by allowing appeals of particular decisions that end with a

³⁵ There is also a substantial empirical literature in economics that links the provision of law and order services with increases in national income. See, for example, Keefer and Knack 1995, 1997.

single individual or durable institution, such as the governor (formeteur or successor) or his council. A network of more or less permanent locations and times may be established at which disputes will be evaluated and judged by company representatives. Again the logic of rational conservatism applies. It will normally be the case that the rules enforced by local authorities are older than the organization currently enforcing them.

It bears noting that the earliest known laws are from the Euphrates valley where governments were based at least in part on monopolized irrigation networks. These laws are known, because they were literally written in stone. The Code of Ur-Nammu was carved into tablets about 4,000 years ago and the Code of Hammurabi was chiseled into basalt a few hundred years later. These legal codes subsequently affected the standing laws of many other communities in the Middle East, including what became Jewish law (Finkelstein 1968–69).³⁶

V. Monopoly Power and Military Organization

The monopoly power theory of territorial governance implies that local governments can emerge more or less peacefully through more or less economic processes. Superior military organization is not a prerequisite for a durable organization's ability able to impose rules on outsiders. It is sufficient that an organization have monopsony or monopoly power. Moreover, physical strength alone does not always allow arbitrary rules to be imposed and sanctioned, except in the short run, because exit is normally possible. The rules imposed by durable governments must be productive ones in the long run or the community ruled tends to disintegrate as residents depart, perhaps secretly, for other communities.

Economic theory, however, also implies that monopoly profits are often only temporarily gained, because success tends to attract rival service providers, unless the

monopoly is a natural one or the present monopoly is able to block entry of new products and rival organizations. In these last two cases, rivals can only obtain similar authority and wealth by taking over the existing monopoly organization. Avoiding such “unfriendly” takeovers can be accomplished through physical means, which implies that military power tends to increase in importance *after* a successful governing organization is established.

Natural and Artificial Monopoly and Military Power

Economists often distinguish between natural and artificial monopolies, and this distinction is of some value for the present analysis. Natural monopolies tend to emerge when there are significant economies of scale in the production so that a market supports only a single efficiently sized firm, or when particular skills or natural resources are available from essentially a single source within the region of interest because of natural genetic or geological variation. Examples of services that exhibit significant economies of scale include irrigation systems, village defense, dispute settlement, social insurance, sanitation services, theology, education, and urban planning. Artificial monopolies emerge when an “entry barrier” is created that allows only privileged organizations to provide particular services in the region of interest. Such privileges may be created by regional governments as a source of revenue and as a means of stimulating competition in other areas as with patents and copyrights of various kinds. Similar barriers to entry are often created by cartels and other associations created for the purpose of limiting entry and coordinating pricing decisions.

Both types of monopoly power provide organizations with additional resources that can be used to advance organizational (formeteur) interests. Both types of monopoly power also give organizations the ability to “impose” penalties on persons outside their organization through denial of services.

³⁶ Religious services are often among the core monopoly services provided by ancient governments, which allow metaphysical threats to be used to enforce rules (Bailkey, 1967). When supernatural threats are believed, this can be a very cost-effective enforcement system. When religious services are not provided by the government directly, religious service monopolies are often supported by regional governments. The monopoly power of state religions often allows them to impose rules on both believers and nonbelievers and to enforce a variety of rules in their own religious court systems. Such courts, for example, were run by both Catholic and Islamic societies during the medieval period.

In some cases, the resources available to the organization can be used to erect physical or legal barriers to entry (a village wall, moat, or gatehouse) in a manner that increases an organization's monopoly power. Similarly, the ability to write and enforce rules can be used to produce and protect "artificial" monopoly power and also protect the claims of those currently holding it. As noted in contemporary literature on regulation, monopolization of markets that are not natural monopolies often involves adopting and enforcing rules that reduces the viability of organizational rivals.

Rivals may be prevented from serving particular markets, forcibly closed down through force of arms, or required to provide their services at relatively unprofitable prices (Lott 1990). The organization of brute force is, thus, an important method for protecting monopoly power and for extending it. To the degree that military force or threats can be used to reduce competition and increase exit costs, an organization's control over resources (profits) are increased and organizational costs are reduced, which tends to increase organizational viability, as long as mass exodus is not induced.

Military Competition and Monopoly Profits

When an organization successfully monopolizes coercive power within a given region, it is clear that the task of maintaining the organization is greatly simplified, at least in the short run. Its ability to monopolize markets is increased. The confiscatory powers and credible threats associated with military power make it easier for such organizations to "extract" the resources required to sustain their team members and to weather the temporary setbacks. The emergence of militaristic norms and other forms of loyalty (patriotism and nationalism) also tends to reduce the cost of solving team production and coordination problems within the organization and within their community.

In cases in which enforcement takes the forms of physical harm, rather than denial of services, and there are economies of scale in physical coercion, dispute resolution within a given territory will take place by the physically strongest organization. In such cases, it may literally be the case that "might makes right."

The winner-take-all nature of military contests, however, implies that when conflict over territorial governance occurs, it will generally consume substantial resources. The intense short-term nature of such conflicts tends to attract the full attention of the government, which tends to reduce its productivity in other service areas. Monopoly fees and tariffs tend to rise and productive investments tend to fall as monopolists shift resources from peaceful to military purposes in order to resist the takeover efforts of rival organizations. Game theory implies that essentially all of a regional monopoly's profits may be dissipated by such conflict, as in a rent-seeking contest (Congleton, Hillman, and Konrad 2008). And, historically, border conflicts often caused European kings to find themselves on the verge of bankruptcy (Ertman 1997, Ferguson 2002).³⁷

VI. The Organization of Territorial Governance

The ability of territorial governments to impose rules on their "customers" increases their command over resources and thereby provides those organizations with additional resources that can be used to weather difficult times. This makes territorial governments unusually robust and durable organization. Only a few organizations are older, such as religious organizations, and these often have similar monopoly powers and coercive

³⁷ Such intensive border conflicts tend to undermine military explanations for the emergence of "rule-imposing" organizations. It is clear that military organizations could emerge as a natural extension of techniques associated with standing hunting parties, who might begin raiding the stores of neighboring communities as well as nature for food. Such "roving bandits" might settle down and attempt to prosper by reducing competition from other roving bandits, as noted by Olson (1994, 2000); however, unless border conflict can be controlled and exit can be completely ruled out, such "stationary bandits" can succeed in the long run only if they provide services for their residents that are at least as attractive as those available elsewhere (net of exit costs). It bears noting that providing protection from roving bandits is implicitly assumed to be a natural monopoly within Olson's analysis and within Hobbes'.

abilities. Economy of scale in the core services of governments often requires, or at least supports, relatively large organizations.

The rules imposed by governments are backed by threats that may involve denial of services (including banishment from the community) and threats to take property, life, or limb forcibly. Although arbitrary impositions of rules and arbitrary punishments may provide some entertainment for government officials, completely arbitrary rules and punishments tend to undermine the viability of their community and reduce resource stocks and flows on which a territorial government depends. A regional government is not free simply to take or threaten to take everything from those outside their organizations, as long as that which to be taken is produced by other organizations in the community (who may refuse to comply) or exit is possible. Moreover, not all rules increase an organization's command over resources in the short or long run. Consequently, territorial governments are rarely totalitarian regimes.

As Mancur Olson (1993) points out about dictators, a territorial government that has its own interests at heart often has good reason to increase general prosperity, because it often profits directly or indirectly from that prosperity. In contrast to the Olson (1993) and Olson and McGuire (1996) analysis, however, the present analysis suggests that the source of a regional government's coercive power is its productivity, rather than its productivity being a consequence of its coercive power. Little can be "extracted" from communities that are not already reasonably well served, well motivated, and well organized.

Similarities with Other Durable Organizations

In this and in other respects, the analysis suggests that regional governments tend to be very similar to other durable organizations. As true of other organizations, the policymaking architecture is normally drawn from existing templates, among which the

king and council template will be prominent. If founded by a single formateur, a good deal of policymaking authority will reside with the community's chief, mayor, governor, or king, and somewhat less authority will tend to be available to its council of wise men, town council, or parliament. If founded by a group of formateurs or as an alliance of other regional governments, the council will tend to be the dominant policymaking authority and the chief executive officer will, for the most part, be responsible for assuring that council decisions are effectively implemented.

As true of other organizations, a mixture of pecuniary and nonpecuniary rewards and punishments, as well as local norms, will be used to solve the government's internal incentive problems. There will also be standing procedures for making policy decisions and standing procedures that address succession. As also true of other organizations, these reflect both past institutional experimentation and institutional conservatism. Territorial governments have, however, greater latitude for arbitrary rules than many other organizations, because of their greater monopoly and monopsony power.

As true of other organizations, there are benefits associated with institutional conservatism. Consequently, only very minor revisions of standing rules for making government policy tend to occur, because of the advantages of stable governance and uncertainties associated with experimentation. And, the persons inhabiting the offices of durable organizations change far more frequently than their core procedures of governance. As the English saying goes, "the king is dead, long live the king," the offices of durable organizations last longer than the persons holding positions of authority.

Territorial governments generally benefit from the rule of law, because their community tends to be more prosperous, if the rules enforced are well understood and the consequences of noncompliance predictable. The rules, however, may not be the same for all persons or yield equitable results. Tax law, criminal law, and civil law tend to

be stable, indeed more stable than the organizations that enforce them, but tend to apply to different persons, occupations, or classes in different ways.³⁸

Reform Pressures on Governmental Organizations

To say that governments are driven by rules, is not to say that they are static inflexible organizations. Techniques for securing control over community resources often change through time as technologies change. Direct taxation may replace complex pricing and sale of monopoly privileges. Roads may be paved, and bridges made of stone may be replaced by ones of steel. The police may replace clubs with guns or vice versa, and so forth. At times of economic or military crisis, pressures clearly exist on governmental decisionmakers to make correct decisions, because mistakes in diplomatic and military strategy may end the regime. Because resources available at such times reflect past decisions on a variety of other matters, these other policies can also significantly reduce the quality of life for governmental leaders and mistakes in the long run may cause a territorial government or community to disappear completely. Gross failures will lead to exit of residents and their mobile factors or attract the attention of potential rivals, who naturally see weakness as an opportunity for takeover.

Partially for such reasons, the territory ruled tends to vary through time, as noted by Dudley (1991) and many others, because the territories controlled by more or less efficiently sized territorial governments tends to vary with the technologies of organization, monopoly services, military techniques, and geography (Jones 2003). For example, Denmark's monarchy began by ruling a subregion of present-day Denmark and grew to include most of Scandinavia and much of northern Germany and then shrank to its present bounds in the course of several centuries with only a few significant reforms of its main procedures for selecting government policies.

The organizational structure of governance may also be revised as opportunities emerge to advance the interests of those inside the organization with the authority to

change those institutions. As in other cases, opportunities for improved decision and incentive systems may result from the innovations of rival organizations. For example, many of the North American colonies were originally authoritarian business enterprises and religious organizations. Exit was difficult. The natives were not always friendly, and return voyages were expensive and dangerous. Fortunately, there was sufficient mobility and competitive pressure among the colonial enterprises that their authoritarian regimes (and in some cases totalitarian ones) were rapidly replaced with relatively liberal parliamentary systems that promised greater protection of the rule of law than in the home country and attracted significant in-migration. This, as developed below in chapter 18, was not a consequence of benevolence on the part of the charter companies or the crown, but rather of mobile factors that were sensitive to improvements in local rules and enforcement practices.

As monopolists, however, regional governments normally face less competition for resources than most other organizations, and their greater control over resources implies that they are subject to fewer exogenous shocks requiring major adjustments. Consequently, the incentives for governments to alter their decisionmaking procedures and reward systems through time tend to be weaker than for many other organizations—although both formateurs and their successors remain interested in reforms that improve the efficiency of governance in the sense that unnecessary costs are avoided or available resources increase. External pressures for reform also tend to be weak relative to that of other types of organizations because governments tend to be larger and more complex organizations, which implies that risks associated with reform tend to be larger than for other organizations. The durability of governments also implies that policy decisions are usually made by successors, rather than formateurs, who tend to be relatively more dependent on existing procedures and routines for their positions of authority and so are less prone to experiment than are formateurs.

³⁸ Such long-standing rules are often regarded as “natural laws.” A sure-fire method of reducing compliance is to change long-standing rules. Tax rebellions, for example, are often consequences of efforts to add new tax bases or to increase taxes substantially on existing taxes. Such “rebellions” are not always military affairs, but simply widespread refusal to abide the new laws (Cohn 2004, Adams 1998).

The reforms that governments tend to adopt will, consequently, tend to be relatively infrequent and relatively modest ones that advance “insider” interests, rather than great revolutionary ones that advance the interests of “outsiders.”