

*Perfecting Parliament*

**Perfecting Parliament:  
Liberalism, Constitutional Reform  
and the Rise of Western Democracy**

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This book is dedicated to my teachers, colleagues, family, and friends, without whose support and thoughtful criticism over many years, it could never have been written.

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## **Preface**

Two political revolutions occurred gradually in Northern Europe during the nineteenth and early twentieth centuries. First, political authority shifted from kings to parliaments. Second, parliaments became more broadly grounded in popular suffrage. This century-long shift in political authority was a major event, although the individual shifts of power and expansions of suffrage were often relatively small events. Nor were these two shifts of policymaking power entirely connected. European parliaments had occasionally gained power in previous periods without broadening their electoral base, which before 1800 were generally limited to well-organized and well-born elites. In some cases, suffrage expanded more rapidly than power shifted to the parliament, as in Germany, whereas in other cases, such as England, parliament became the dominant institution for public policymaking well before universal suffrage was obtained. Yet, by the 1920s the new democratic parliamentary governments were broadly similar throughout Europe and were radically different from previous governments that Europe and the world had experienced during recorded history. These new parliamentary governments were revolutionary, although not products of war, nor sudden breaks with the past. Something evidently had happened during nineteenth-century Europe that gave rise to gradual, but extraordinary, changes in governance in the course of only a century or so.

It has often been suggested that industrialization played a role in these constitutional reforms. To the best of my knowledge, however, no one has provided a peaceful mechanism through which industrialization—itsself largely an economic activity—may induce major political reforms. Whether economic development induces constitutional reform or constitutional reform induces industrialization is not obvious. After all, it is political decisions that determine contract, property, and tax laws, and it is political decisions that largely determine how those rights and obligations will be enforced. Economics suggests that such political decisions can have large effects on a nation's path of economic development by affecting transaction costs, technological innovation, and market size. One could argue that national governance largely determines market activity, even in a fairly complete model of political economy.

It seems likely, however, that causality is not unidirectional from the political to the economic sphere. An interdependence clearly exists between economic and political activities in the small, as when individual pieces of legislation or administrative rulings are influenced by the testimony and lobbying efforts of organized economic interests. The present analysis suggests that this is also true in the large, because major constitutional reforms can be induced by politically active groups whose economic interests are advanced by such reforms. Technological and ideological innovations may create new opportunities and new pressures for

peaceful constitutional reform that favor particular political and economic interests. The effectiveness of such groups tend to be enhanced by industrialization, but the groups are not products of industrialization

The analysis developed in this book suggests that the road to democracy requires institutions in which constitutional bargaining and reforms can take place, and support of politically active persons with an interest in more liberal forms of political decisionmaking. .

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[The] members of parliament had been recalled, so far as the government was concerned, for one reason and one reason alone: money ...

In the end the members of parliament accepted the king's assurances and decided to "proceed notwithstanding." They now wanted confirmation of the adequacy of their offer, and also a more concrete set of proposals outlining what the king might surrender in return ...

Rabb (1998: 140, 149) on Sir Edwin Sandys and the great contract of 1610.

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The **best aristocracy** is that in which **those who have no share in the legislature are so few** and inconsiderable that the governing party has no interest in oppressing them.

Thus, when Antepater made a law at Athens, that whosoever was not worth two thousand drachmas should have not power to vote, **he formed by this method the best aristocracy possible**; because this was so small a sum as to **exclude very few**, and not one of any rank or consideration in the city. Montesquieu (1748: 15)

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## **Chapter 1: On the Origins of Western Democracy**

### **A. Introduction: On the Evolutionary Character of Western Democracy**

Most of us in the West take our contemporary form of governance and political theories for granted. The practices of selecting representatives through elections based on broad suffrage, the concentration of legislative authority in elected parliaments (legislatures), and the holding of annual meetings of parliaments have become the normal routines of political life in the West. That governance should be grounded in the consent of the governed, that various civil liberties should be essentially absolute, and that all citizens should be equal before the law are nearly universally supported and largely unquestioned. That representative governments should adopt laws in a manner consistent with constitutional procedures and constraints is so broadly accepted that it is hard for most of us to imagine any other legitimate form of government.

Most of us also acknowledge that much of the general architecture and many of the principles of contemporary governance are far older than our governments. The idea of the rule of law, if not equality before the law, can be traced back at least as far as the code of Hammurabi, which was chiseled into stone tablets in about 1775 BCE. The foundation of many of our political theories about representative government can be found in classical Greek philosophy, as in Aristotle's *Politics* written in about 330 BCE. Parliaments themselves date back at least to the late Middle Ages, as do elections for seats in parliament. Yet, we also understand that constitutional governance based on equality before the law and broad suffrage is a relatively new phenomenon.

Parliaments, diets, and assemblies have long played a role in Western governance, but membership in medieval parliaments was not grounded in broad suffrage, but rather heredity and occupation. Medieval parliaments were, for the most part, populated from relatively wealthy families and were subordinate to their kings or queens. Medieval parliaments were not self-calling. Kings and queens called "their" parliaments into session whenever convenient and dismissed them at a whim. Their relatively short meetings were largely a method for kings to communicate their ideas and policies to regional elites, and to request new taxes from them. Apart from veto power over new taxes, medieval parliaments had very limited authority. As a consequence of the success and defense of those institutions, analysis of alternative institutions for governance largely disappeared from European philosophical and political discourse during the thousand years prior to the sixteenth century.

To simultaneously accept the “newness” and “oldness” of contemporary political theory and institutions is not evidence of poor training or confusion, but rather acknowledgment of elements of continuity in both the theories and institutions of governance. The ideas of popular suffrage and representative governance are quite old, but broad support for the ideas of popular sovereignty, equality before the law, and universal suffrage is much newer. Many European parliaments are centuries old, but much about the institutions of contemporary parliamentary democracy is quite new.

The emergence of contemporary Western democracy from the medieval template required two major reforms of the routines of governance, and these reforms were widely adopted in northern Europe, North America, Australia, and Japan during the nineteenth and early twentieth centuries. First, political authority had to shift from kings to parliaments. Second, representation in parliament had to become more broadly grounded in popular suffrage. Perhaps surprising, these reforms were not products of war, nor of sudden breaks with the past. Indeed, even in the United States and France where “revolutionary” wars were fought, the wars themselves did not produce democratic parliamentary governance. Nor was there an obvious trend in medieval governance that somehow culminated in the nineteenth century. Something extraordinary happened during the eighteenth and nineteenth centuries that gradually produced parliamentary democracy through a long series of reforms.

This book explains (i) why contemporary liberal democracies are based on historical templates rather than revolutionary reforms, (ii) why the transition in Europe occurred during a relatively short period in the nineteenth century, (iii) why politically and economically powerful men and women voluntarily supported such reforms, (iv) how interests, ideas, and preexisting institutions affected the reforms adopted, and (v) why the countries that liberalized their political systems also produced the Industrial Revolution. The analysis is organized in three parts. The first part of the book develops a bargaining and exchange theory of constitutional governance and reform. The second part uses historical case studies to determine the relevance of the theory. These historical narratives provide evidence that Western democracy emerged from a long series of liberal constitutional reforms, rather than from a single great leap from authoritarian to democratic governance. The last part provides additional quantitative evidence in support of the theory, summarizes the results, contrasts the approach taken in this book with that used by other scholars, and discusses methodological issues.



## **B. Weaknesses of Revolutionary Explanations of the Emergence of Parliamentary Democracy**

The leading alternatives to the explanation provided in this volume are based on “revolutionary” theories of constitutional development.

The militant version of the revolutionary hypothesis argues that major economic and political reforms occur in great leaps associated with broad public uprisings that threaten political elites. The fear that their regimes will be overthrown through civil war induces the elite to flee or to accept the “demands” made by their revolutionary opponents. In this manner, it is argued, credible threats of violence can produce radical democratic reforms, sometimes without much actual warfare (Acemoglu and Robinson 2000, Palmer 1959).

There are several major problems with such “popular revolt” theories of the emergence of liberal democracy. Neither major revolutionary threats, nor wholesale reform of institutions, are evident in the countries that adopted liberal reforms in the nineteenth century, except occasionally in France. Moreover, serious revolutionary threats require well-organized, hierarchical organizations with guns, which tend to promote post-revolution dictatorships, rather than democracies. Here, one can recall that civil wars in England, France, Russia, and China produced Cromwell, Napoleon, Lenin, and Mao, rather than durable liberal reforms and democratic rule by the people through elected representatives. Outside of France, there are no cases in which armed conflicts produced even temporary democratic reforms during the nineteenth or early twentieth centuries. And, neither of the two French revolutions created durable democratic systems of government. The first Republic quickly succumbed to the Committee of Public Safety, followed closely by the rule of Napoleon I. About a half century later, King Louis-Philippe abdicated in the face of a popular uprising. The latter was a rare instance of regime change generated by widespread revolt, which seems to be largely responsible for the militant explanation of the emergence of democracy. The second Republic, however, lasted just four years before yielding to the rule of Napoleon III. The subsequent emergence of liberal democracy after Napoleon III was largely evolutionary in nature. The French Parliament had already acquired considerable authority over public policy, and suffrage had been expanding before the second revolution.

In cases in which the force of arms played a role in assembling new, more centralized nation-states, as in Germany and Italy, the new national governments were only slightly more liberal than the typical regional governments they included. In cases in which wars of secession were

successful, as in Belgium and the United States, relatively democratic representative systems of government were already in place prior to secession, which were often liberalized after the war was won, but over many years. Military organizations are rarely themselves liberal forms of government.

The other revolutionary explanation for liberal reforms in the nineteenth century focuses on intellectual and ideological changes, rather than military threats or peasant uprisings. Such theories argue that radically new ideas swept through Europe that persuaded everyone of the merits of new forms of government. There is more historical and constitutional support for the intellectual innovation thesis than the military threat models and for intermediate models that combine ideological shifts with revolutionary threats.

It is certainly true that the intellectual base for governance changed in the nineteenth century. It is also clear that enlightenment theories of the state, society, and economy affected nineteenth century constitutional developments. For example, by the early twentieth century, many European constitutions explicitly mentioned popular sovereignty and equality before the law. These foundations for governance clearly contrast with claims made in older documents that stressed noble family trees, divine providence, and history. However, the timing is wrong for the enlightenment theory of liberal constitutional reform.

Theories supporting popular sovereignty, contract-based governance, and civic equality were penned many decades, indeed centuries, before the political reforms of the nineteenth century began in Europe. Locke, Montesquieu, Rousseau, Paine, Smith, and Madison wrote in the seventeenth and eighteenth centuries, rather than the nineteenth century. And, the writings of these influential political and economic theorists were preceded by earlier arguments and documents associated with the Dutch revolt of the late sixteenth century and by the English Levelers and North American colonists of the early seventeenth century. Although enlightenment scholarship—as well as nineteenth-century restatements and extensions of them—affected debates on institutional reform within literate society and relatively open parliaments in the eighteenth century, it seems clear that simply writing down and circulating such “revolutionary” ideas was not sufficient to cause significant democratic reform.<sup>1</sup>

<sup>1</sup> Indeed it can be argued that the intellectual basis for governance began to shift much earlier. Some scholars argue that this shift began with the renewal of interest in Greek political philosophy, with its emphasis on reason, observation, deduction, dialogue, and education in the mid to late middle ages. This renaissance accelerated in southern Europe in the fifteenth and sixteenth centuries after the fall of Byzantium in 1453 (Wilson 1992). In the seventeenth and

Continued on next page...

Given this timing problem, those stressing the role of revolutionary ideas might argue that it was nineteenth, rather than seventeenth and eighteenth century, ideas that motivated constitutional demonstrations and reforms. Perhaps, the ideas of Mill, Marx, and other late nineteenth century social reformers generated the democratic impulse for democratic reforms, rather than enlightenment scholars. Again, some evidence supports this idea. Large-scale demonstrations were organized by radical liberals, labor unions, and social democratic political movements in the late nineteenth century, and these often supported suffrage expansion even in cases in which the main goals were economic, rather than political, reforms. However, again the timing is wrong. Shifts of authority from kings to parliaments and a gradual increase in suffrage often began in the first half of the nineteenth century, well before blue-collar labor movements emerged and, moreover, were often completed before radical liberals or labor and social-democratic parties became significant participants in government.

Another significant weakness in these theories is the “quantum leap” hypothesis. Shifts to democratic governance in the nineteenth century were rarely sudden and did not require radical breaks with older institutions. Rather, new systems of governance emerged gradually, as long-standing political institutions were revised a little at a time. In some countries, the steps were larger than others, but in no case did parliamentary democracy emerge in a single great constitutional leap. The gradual emergence of modern parliamentary democracy is evident in the core architecture of contemporary constitutional democracies. The most obvious cases are those in which a monarch still occupies the national throne, as in the United Kingdom, Koninkrijk der Nederlanden (the kingdom of the Netherlands), Konungariket Sverige (the kingdom of Sweden), and Royaume de Belgique (the kingdom of Belgium). Democratic republics also have an executive branch headed by a single person and a parliament or legislature organized more or less as a large committee that makes decisions by casting votes.

Moreover, there was nothing particularly unusual about the adoption of modest constitutional reforms in the nineteenth and early twentieth centuries. Individual constitutional and regulatory reforms of similar magnitude had occurred in previous centuries in most of the West.

What was unusual about the nineteenth century was a strong trend in the policy, legal, and constitutional reforms in a handful of countries, rather than a random series of reforms and counter-reforms. At the end of a century or two of more or less peaceful and lawful reform, there

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eighteenth centuries, however, successive generations of scholars and practitioners went beyond the Greek theories of the state and developed new theories of legitimate governance, including new contractarian arguments for states grounded on popular sovereignty.

was a completely new method of choosing parliament and completely new division of policymaking authority between the king and parliament. Parliamentary democracy had emerged.

### **C. The “King and Council” Template for Governance**

In practice, most governments include a “king” and a “council,” that is, a branch of government headed by a single chief executive and another composed of a committee of more or less “equals” who make important decisions by counting votes.<sup>2</sup> Such divided forms of government extend back to the dawn of recorded history (Bailkey 1967). This template for governance might have been called a “chief and council of wise men” in early societies, a “king and royal council” in early medieval times, a “king and parliament” in the late medieval and early modern periods, and a parliament and prime minister (or congress and president) in contemporary governance. By sharing this essential architecture, modern parliamentary governments reveal their deep historical roots and also suggest that contemporary divided forms of governance reflect a good deal of past institutional experience.

A wide variety of governments can be formed from the king and council template, because policymaking authority can be distributed in a number of ways between the king and council, and because the “king” and the “council” can be chosen in a number of ways. Such divisions of authority and selection procedures allow the king and council template to be used to make policy decisions in dictatorships, mixed governments, and parliamentary democracies. In authoritarian states, the executive has most of the policymaking and appointment authority, and the council serves a largely advisory role. In such cases, the council makes suggestions to the “ruler,” rather than rules, and kings and authoritarian presidents accept or reject this advice insofar as it advances their interests.

In mixed or intermediate forms of the king and council architecture, authority to direct governmental resources to particular courses of action is divided between the king and council. For example, the king may decide on international relations, and the parliament may decide on domestic budgets. The authority to select other policies may be shared. In contemporary presidential systems, the parliament and the president jointly determine public policy, insofar as veto and agenda control are distributed between the legislature and president. In contemporary parliamentary democracies,

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<sup>2</sup> This general architecture also tends to be commonplace among most contemporary dictatorships.

the council (parliament) is dominant. The parliament makes the rules and appoints the chief executive (prime minister), who serves at the pleasure of parliament.

Procedures for selecting officeholders may also be varied, as for example, officeholders may inherit their positions, be appointed by one or more preexisting bodies, or be elected. When elected by committees or larger groups, the voting rules may be adjusted in various ways. Votes may be weighted in various ways, super majorities may be required or not, and constructed in various ways. The qualifications for suffrage may be varied to include more or less voters. Together the variations in the division of authority and in the rules for selecting officeholders create a continuum of governmental institutions, as is necessary for democratic governance to emerge gradually, without radical changes in governance.

In national governments there are normally a variety of councils (committees) with somewhat different responsibilities. For example, most medieval kings had executive councils (a council of state or a cabinet) in addition to “their” parliaments. Today’s parliamentary democracies also include an executive cabinet or ministry. It is, however, the relationship between parliament and executive (king, prime minister, or president) that is most relevant for this book, although shifts in the authority to appoint “executive” cabinets play an important role in transitions to parliamentary rule.

Together the “political property rights” established by a given implementation of the king and council template and the many possible divisions of policymaking authority within that template allow the possibility of constitutional exchange. Authority to revise public policy within divided governments may peacefully (and lawfully) shift from one branch of government to another through formal and informal amendments, without changing the essential architecture of government. Both reform and continuity are evident in the nineteenth century constitutional bargains that gradually produced Western democracy.

Aristotle called these intermediate cases mixed governments, but devoted most of his analytical work to the extremes (pure forms), an emphasis that continues to the present-day in most theoretical work on political decisionmaking. Nonetheless, the classical Greek scholars who produced the discrete classification schemes of political institutions so widely used today (autocracy, aristocracy, and democracy) acknowledged that “mixed” governments were more common than the pure forms they named and analyzed. The medieval governments from which Western democracies emerged were all based on the king and council template, and all modern democratic governments continue to be based on that template.

The shifts of policymaking authority that occurred in the nineteenth century were not inevitable. They had not happened before, and they did not happen in many places. They did not happen suddenly, but through the cumulative effects of a long series of reforms to a single more or less stable architecture of governance. In most cases, these reforms were adopted without obvious threats of civil war, although there were often large peaceful demonstrations favoring relatively narrow economic and political reforms. The theory developed in this book provides an explanation for both the timing and direction of these constitutional reforms.

#### **D. A Theory of Peaceful and Lawful Constitutional Reform**

The analysis and historical narratives focus on two neglected features of constitutional (rule-based) governance. First, they focus on the divided nature of essentially all medieval national and duchy governments. Second, they note that the written (and unwritten) constitutions of these governments defined political property rights, which could be and were traded, just as property rights for ordinary commodities can. The multidimensional nature of authority over policymaking within divided governments, perhaps surprisingly, implies that reassignments of political power are not always zero-sum games.

The term “compromise” is often used to describe bargaining within parliaments and between parliaments and their sovereigns, but compromise is in most cases simply another word for negotiation and exchange. The parties to a compromise gain advantages from the terms negotiated, at the same time that they sacrifice other aims to bring negotiations to a successful conclusion. It is clear that the same terms could also be used to describe haggling over prices in markets without posted prices. Mutual gains from constitutional exchange occasionally emerge, which can be realized by amending the preexisting constitution. Such shifts of “political power” within divided governments may advance some aims more than others, but they are rarely “forced” any more than sales in commercial markets are.

In the nineteenth century, trends in constitutional and economic reforms emerged from technological and ideological innovations that jointly produced new economic and ideological interests. The consequent trends in political and economic reforms were termed “liberal” in the nineteenth century and also throughout this book. Liberal reformers pressed for policy and constitutional changes that increased civil equality, opened both commerce and politics to value-increasing forms of competition, and increased rates of technological innovation throughout

the West. Both parliamentary democracy and industrialization were consequences of the political successes of liberal reformers.

The exchange-based theory of constitutional reform proposed in this volume can account for the historical roots of parliamentary governance, for the timing of the liberal transitions, and for the path of reform through which parliamentary democracy emerged. It bears noting, however, that the constitutional-exchange path to democracy is not a one-way street. In opposite circumstances, policymaking authority of parliament can be shifted to a “king,” and suffrage may be restricted, rather than expanded. The former is a relatively common event in history, and the latter also occurs from time to time, as noted below in the case studies.

## **E. Organization of the Book**

Part I develops a theory of governance grounded on a theory of organizations. The theory is for the most part developed using nontechnical prose, although some mathematics is used to illustrate problems that can be solved through organization and also to demonstrate that opportunities for constitutional reform can emerge as a consequence of changes in the distribution of wealth and ideology among those with the power to adopt such reforms. For the most part, the mathematics can be neglected by readers who are more interested in the essential logic of the analysis than demonstrations of logical consistency.

The models imply that constitutional bargaining is likely to be nearly constant, although constitutional bargains will be less commonplace. The model also suggests that the reforms adopted will be relatively small and will reflect both the preexisting amendment procedures and the ideological and economic interests of those sitting at the table at the time that reforms are adopted. This is not to say that every constitutional exchange leaves those “at the table” with “smiles on their faces” any more than every market transaction equally pleases buyers and sellers, but it is to say that the bargains reflected the interests of those at the table, given the circumstances at the time the terms of trade were negotiated. Civil war or threats of such wars can create opportunities for constitutional exchange, as argued by Acemoglu and Robinson (2001), but they are neither prerequisites for constitutional reform, nor very likely to induce liberalization.

Part II of the book attempts to determine the extent to which the models of governance and reform developed in part I can account for the emergence of Western democracy in the late nineteenth and early twentieth centuries. The case studies suggest Western constitutional history is largely consistent with the models. Western democracy emerged from a long series of fine-grained

formal and informal bargains over constitutional details, rather than bold, ingenious, revolutionary innovations adopted under the threat of violence.

“Exogenous shocks” can produce new alignments of constitutional interests and more energetic, persuasive campaigns by ideological and economic interest groups. European constitutional reforms were indirectly triggered by innovations in political theory and in technologies of production. Liberal ideas penetrated into elite circles and the liberal direction for reform was supported by various coalitions of liberals and pragmatists that stood to profit from political and economic liberalization. Early liberal reforms in the United States were triggered by labor scarcity during its colonial period and reinforced by subsequent technological and ideological shifts. Late nineteenth century liberalization in Japan was triggered by military concerns and increased access to European ideas and technologies. In all cases, a large number of new, more or less, liberal economic and political interest groups pressed for a broad range of reforms.

Part III concludes the analysis by providing some additional statistical support for the models of part I, summarizing the main argument, and discussing its relevance for contemporary transitions. A methodological appendix provides a rationale for the approach taken and addresses anticipated criticisms of the book’s grand ambition and scope.

Readers are likely to find some parts of the book to be of greater interest than others. This is a natural result of an interdisciplinary and multi-methodological enterprise such as this one. Indeed some readers have suggested that the history should come before, rather than after, the models. That suggestion was resisted for methodological reasons. Economists will probably find parts I and III to be of greater interest than part II. Political scientists, constitutional scholars, and historians will probably find parts II and III to be of greater interest than part I. All three parts, however, seem necessary to develop and test the theory of constitutional governance and reform proposed in this volume.

### *Part I: Sharing Sovereignty*

Analytical histories have long been used to focus attention on key factors in political and economic development, and that approach is used in part I. Classic works from political science, such as Aristotle’s *Politics* (330 BCE) and Hobbes’ *Leviathan* (1651), use analytical histories to discuss the evolution of institutions and the normative case for particular forms of governance. Rawls (1971) and Nozick (1974) have used this technique to develop theories of distributive justice, and Olson (1993, 2000) has used the analytic approach to develop an explanation for the emergence of



regional governments from bands of roving and stationary bandits. Analytical histories allow a few essential features of a choice setting to be analyzed in an environment that abstracts from the idiosyncrasies of real people and places.

The analytical foundation for the present analysis is a theory of organizational governance. Part I provides an analytical history of governance that begins with a theory of organizational governance and ends with models of constitutional bargaining and suffrage reform. Chapters 2–4 analyze the formation and evolution of formal organizations, their internal incentive structures, and their standing decisionmaking procedures. That analysis, perhaps surprisingly, provides an explanation for some of the main features of medieval and modern governance, and for the dynamics of such governments.

Chapter 2 characterizes some general features of organizations. Organizations are “artificial” choice settings in which a variety of conditional economic and social rewards and punishments are used to align the interests of the organization’s team members with the organization’s survival and success. The reward systems used are partly products of design and partly products of evolution. The persons that create new organizations (formeteurs) normally choose from among preexisting organizational templates and modify those templates for the purposes at hand. Both the internal incentive structures and decisionmaking procedures of formal organizations are chosen by formeteurs and, so, tend to advance their interests.

Large organizations normally have a standing decisionmaking process to devise and modify internal incentive systems, and to determine which goals an organization’s resources should be used to advance. Even profit-maximizing firms tend to have such governmental systems. The “king and council” template is widely used for choosing policies, because it reduces information problems and also tends to reduce unproductive intra-organizational conflict. In cases in which a single person creates an organization, the “king” tends to be the dominant policymaker. In cases in which a small group creates an organization, the “council” tends to be the dominant policymaker. In cases in which a large group creates an organization, a council may be elected or appointed by the larger group to represent their interests in the organization.

Chapter 3 analyzes long-term survival advantages of organizational “rule of law.” Organizations that have stable reward systems, standing procedures for policymaking, and standing procedures for replacing organizational leaders tend to have lower decisionmaking and recruiting costs, which tend to make such organizations more robust in the short and medium run. In the long run, however, some degree of flexibility is necessary. The founders and their successors will need to be replaced,

and decisionmaking procedures that worked well for the founding generation may need to be adjusted to reflect the talents of new officeholders and new circumstances if the organization is to remain viable. The king and council template for governance allows several possible solutions to an organization's transition problems and also allows responsibilities to shift among top officeholders to take advantage of changes in talent and facilitate adjusting to external circumstances.

Chapter 4 provides an explanation for the emergence of regional governments as one of many kinds of organizations in a setting in which migration is possible. Territorial governments are not necessarily the first formal organization, nor are they necessarily central to the emergence of civil society, as often argued (Hobbes 1651; North, Wallis and Weingast 2009). Moreover, the ability of an organization to impose rules on nonmembers does not necessarily require substantial military power. Any durable organization with a bit of monopoly power can impose and enforce rules on persons outside their organization—as; for example, fine restaurants often impose dress codes on their customers. The more important the service(s) monopolized, the greater is an organization's ability to impose such rules without inducing out-migration. From this perspective, territorial governments are simply durable organizations that have extraordinary monopoly power.

The ability to organize violence, however, can make such organizations more durable. For example, regional governments may have to respond to threats from rival organizations outside their territories to protect their monopolies and organizational surplus. Olson (2000) calls such external rivals “roving bandits.” Note, however, that Olson's roving bandits cannot emerge first, because there would be too little for them to steal without preexisting productive organizations and communities.

Chapters 5–8 analyze the extent to which a territorial government's decisionmaking procedures can be reformed through internal bargaining and exchange. An important issue for the purposes of the book is whether shifts of policymaking authority from the king to the council can ever simultaneously advance the interests of king and council. If such cases exist, it implies that constitutional terms of trade can be negotiated and freely adopted. Chapters 5 and 6 demonstrate that constitutional gains to trade can arise and that voluntary transfers of authority are possible within the king and council template for governance. Particular assignments of authority (distributions of veto power and agenda control) and procedures for selecting members of government are “political resources” that can be traded much as ordinary goods and services are in ordinary markets.

Chapters 7 and 8 explore the extent to which economic and political shocks can induce parliament to change the manner in which its members are selected. Chapter 7 demonstrates that peaceful changes in suffrage law cannot be explained by economic changes, such as increased income. Suffrage is not simply a “superior” good that people purchase more of as they become wealthier. It also argues that suffrage reform is unlikely to emerge from a civil war or threat of civil war, because democratic revolutions are difficult to organize and because the hierarchical organizations necessary are not usually inclined to transform themselves into representative democracies after such improbable wars are won. Chapter 8 suggests that peaceful suffrage reform is most likely to occur when ideas about the proper bounds of suffrage change. That is to say, ideology and ideological change appear to be more critical for suffrage expansion than for shifts of policymaking authority from kings to parliament. This partly accounts for differences in the timing of increased parliamentary authority and expansion of suffrage during the various Western transitions to democracy.

Together the prose and mathematics of part I provides several explanations for the wide spread use of the king and council template for governance. It also provides an explanation for the distribution of authority within that template, for changes in that distribution through time, and for the stability of selection procedures for high office. The models also suggest that the standing procedures of governance tend to be fairly stable through time, unless there are trends in external shocks. Without such trends, the distribution of authority between king and parliament (and between the central and regional governments) will resemble a random walk as reforms are adopted and reversed.

With favorable trends, the models imply that liberal trends in constitutional reform are possible. In such cases, constitutional bargaining and exchange can gradually produce parliamentary democracy through a series of reforms that gradually shift policymaking authority from kings to parliament and extend the electoral base for selecting members of parliament.

### *Part II: Historical Evidence on Western Democratic Transitions*

If the choice settings analyzed in the first part of the book are representative of those confronting real persons in real governments, the predicted institutions, interest groups, constitutional bargaining, and reforms should be commonplace in history. For example, one should observe widespread use of the king and council template. There should be ongoing constitutional negotiations and occasional reforms within such governments, but few long-run trends in the

reforms adopted. The individual reforms adopted should be relatively small, but discrete, changes. In periods in which external shocks exhibit strong trends, as in the nineteenth century, there should be similar broad trends in both policy and constitutional reforms. These predictions are largely borne out in the case histories and historical overviews developed in part II.

Part II begins with a general account of the emergence of Western democracy and then explores the transitions of six countries in greater detail. The case studies include three cases in which the theory applies very naturally (England, Sweden, and the Netherlands) and three more difficult cases (Germany, Japan, and the United States). In four of the cases, transitions to parliamentary democracy occurred without dethroning the royal families. In one of the cases, the transition reversed and the king regained his authority. All but one of the narratives focus on developments in the nineteenth and early twentieth centuries. The exception is the American case, which began nearly two centuries earlier than the transitions in Europe and Japan, although its transition can be said to have ended at about the same time (with the adoption of woman's suffrage in the early twentieth century). Other case studies could easily be developed, but that is left for future research.

Both the overviews and the case histories are somewhat novel in that they focus narrowly on constitutional developments, rather than personalities, international entanglements, or sociological trends, except as these bear directly on constitutional bargaining and reform. Needless to say, more could be written about every case developed. Indeed there are cases in which historians have written books on material covered here in just paragraphs; however, sufficient detail is provided to give readers a sense of the interest groups at work, the ongoing constitutional bargaining, and the long series of reforms that produced parliamentary democracy in the countries of interest. Most general national or period histories include a wide range of details that had little effect on constitutional developments and tend to neglect minor constitutional reforms that play important roles in the emergence of parliamentary democracy. Most historical case studies focus on a single country at a single point in history and fail to note parallels in other national histories.

Chapters 9–11 provide an overview of political, economic, and constitutional developments in the West during the eighteenth and nineteenth centuries. The overview focuses for the most part on European developments, because most Western democracies are either physically in Europe or initially had governments whose structures were determined by European politics. (In many cases, European templates for government were simply exported to European colonies with minor adaptations for local conditions. Those of Meiji Japan were influenced by European templates.)

The process through which the constitutional reforms were adopted is consistent with the analysis of part I. In all cases, parliamentary democracy emerged from a series of reforms, rather than in one or two great quantum leaps, although some reforms could be said to be more important or larger than others. Constitutional bargaining is evident in most countries prior to 1830 and significant institutional innovations were adopted, but the balance of authority between king and parliament lacked a clear long-run trend. In contrast, constitutional reforms in the century between 1830 and 1930 exhibited clear liberal trends. In essentially all cases, liberal reforms were adopted using preexisting constitutional rules for amendment. In no case is every liberal reform preceded by a large-scale revolt, and in most cases, there are examples of large-scale demonstrations that failed to produce obvious reform.

The main trigger for the constitutional reforms of nineteenth-century Europe is argued to be changes in economic and ideological interests associated with new economies of scale in production. The new economies of scale favored economic and political liberalization. Liberal trends in reform are evident in many areas of policy, including education, civil liberties, and more open trade. Liberal trends are also evident in political reforms that affected the division of authority between the king and parliament and the basis for holding seats in parliament. Both industrialization and democracy were long-run consequences of liberal successes. In countries where liberals were unsuccessful, neither industrialization nor democratization took place in the nineteenth century.

The historical overview is followed by six more detailed constitutional histories. The first three country studies are cases in which all the elements of the model are evident: the United Kingdom (chapters 12–13), Sweden (chapter 14), and the Netherlands (chapter 15). The timing of their transitions differ somewhat, but in all three cases parliaments gradually gained authority, suffrage was gradually broadened, and kings (and queens) gradually lost most of their authority over public policy. Their respective royal families, nonetheless, retained their titles, palaces, and modest formal authority, which would not have been the case if true revolutions had occurred. Similar chapters could have been written about Belgium, Denmark, and Norway.

The second three cases are more difficult ones, in which some elements from the theory are missing. The purpose of exploring such cases is partly to show that similar negotiations were taking place elsewhere and partly to demonstrate that technological and ideological shocks do not always produce parliamentary democracy, even when substantial internal pressure for liberalization exists. Such economic and political changes simply make such transitions more likely. The three difficult cases are: Germany (chapter 16), Japan (chapter 17), and the United States (chapter 18). Germany

failed to find a bargain that would allow the last steps to parliamentary democracy to take place prior to World War I, although negotiations were undertaken and helped produce parliamentary democracy in Germany after the war was over. Japanese political leaders engaged in essentially nonstop constitutional bargaining that produced universal male suffrage and party governance in 1925, but political and economic policy shifted in an authoritarian direction in the next decade. The United States succeeded in its transition to liberal democracy, but it took a longer time, was initially catalyzed by somewhat different factors, and produced a somewhat different political system. Similar difficult-case chapters could have been written about France, Italy, Spain, and several South American countries.

Overall, the six country studies demonstrate that new economic and ideological interests and preexisting institutions played important roles in the constitutional bargains that gradually produced Western democracy. The cases also cast doubt on several alternative non-revolutionary explanations for the emergence of the West. For example, they demonstrate that religion and other preexisting aspects of culture and institutions are less important factors than one might have expected. Belgium and Japan were not Protestant. Neither Sweden nor Japan was ever ruled by Rome. The transitions in the United States and the Netherlands were not preceded by long periods of stable, more or less constitutional rule by a monarch.

### *Part III: Analytical History as Social Science*

Part III develops additional evidence in support of the exchange theory of constitutional reform, summarizes the results, addresses methodological issues, and discusses the theory's relevance for contemporary transitions. Chapter 19 provides some statistical evidence in support of the hypothesized links among technology, liberal interest groups, and constitutional reforms. The statistical evidence affirms the hypothesis that the Western democracy and industrialization were interdependent phenomena. There is evidence of "boot strapping" and joint causality. Chapter 20 concludes the book. It summarizes the main results, contrasts the approach used here with that used by other scholars, and suggesting possible extensions. Additional methodological issues are addressed in a short appendix.

Although the book includes a good deal of history and reflects many years spent reading early constitutional documents and books written by careful historians, *Perfecting Parliament* is not intended to be primarily an historical work, but rather a contribution to social science. It attempts to develop and test a particular theory of constitutional reform.

The lasting effects of the reforms of the nineteenth century are still evident in the West today. Essentially all of today's mainstream Western political parties would be considered "liberal" on the great constitutional issues of the nineteenth century. Trade is substantially free, public education widespread, equality before the law is nearly taken for granted, and governance "of the people for the people" has proven to be a remarkably good form of government relative to the others that remain. The West dominates lists of countries ranked by average income, civil liberties, political liberties, lack of corruption, literacy, and longevity and continues to be a magnet for emigration from other parts of the world.

Yet, there is nothing really unique about the West beyond its fortunate century or two of liberal reform. It is not uniquely populated with wise leaders, clever entrepreneurs, or political philosophers. Thus, it is quite possible that similar, essentially peaceful reforms can occur elsewhere, as seems to have been the case in several other parts of the world in the past few decades.

## **F. Acknowledgments: Support and Influential Precursors**

It can be said that this book began as a short paper on Swedish constitutional reform, which through the support and encouragement of the constitutional project at the Studieförbundet Näringsliv och Samhälle (SNS) became a short book on Swedish constitutional reform. That project raised questions that required a much longer book to answer.

At first, I believed that Swedish constitutional history was unique, because most general histories of other countries emphasize revolutions of one kind or another. The words "revolution" and "crisis" appear over and over in historical work. However, as I read more detailed accounts of constitutional developments, they seemed to be more similar to the Swedish constitutional history than one might have expected, given the revolutionary narratives. There was often little evidence that violence or major threats of violence played a direct role in those reforms, although there were often peaceful demonstrations in support of reform. Moreover, it seemed clear that liberalization took place through a variety of legal and procedural reforms, rather than through a single democratic leap forward. Bargaining and lawful constitutional reforms were much more commonplace than the violent, illegal, uprisings, and constitutional conventions that such narratives required.

How peaceful and lawful transitions could occur, however, remained a great puzzle, and to piece together an answer took seven more years of reading, puzzle solving, and writing.

*The Rational Choice Approach to Constitutional Analysis*

Contemporary analysis of constitutional designs using rational choice models began in 1962 with the publication of *The Calculus of Consent* by James Buchanan and Gordon Tullock. They used models of individual interests and elementary game theory to assess the properties of a fairly broad range of constitutional alternatives. Their work and much that followed provided new rational-choice foundations for an older political science literature on the role of institutions in governance that extends back to Aristotle's *Politics* and beyond. Buchanan's subsequent work stressed the distinction between two levels of analysis: the constitutional level, which determines the rules of the game, and the ordinary play of the game under those rules. This volume essentially adds a third level of analysis, that of constitutional reform, to the Buchanan schema of "rules of the game" and "play under the rules."

The half century of analytical literature on constitutional design includes hundreds of academic papers that attempt to determine the interdependence between the standing routines of governance and public policy. See, for example, Riker (1962), Buchanan (1975), Baron and Ferejohn (1989), and Mueller (1996). Surveys of the theoretical and empirical literature are provided by Mueller (2003), Cooter (2002), Persson and Tabellini (2003), and Congleton and Swedenborg (2006). The evolution of economic and political institutions has been discussed by Hayek (1982), North (1990), Ostrom (1991), Vanberg (1994), Spruyt (1994), Finer (1997), De Mesquita, Smith, Siverson, and Morrow (2004), and North, Wallis, and Weingast (2009), among many others. In most cases, however, the research provides more insight about the effects of particular institutions than about how those institutions came into existence at particular times and places.

The process through which durable procedures for policymaking are adopted and refined through time has attracted surprisingly little attention from rational choice-based research. This lacuna is important, because the existing literature implies that small changes in political architecture can have significant effects on the course of public policy, which in turn can have significant effects on economic and social life. This book shows that a particular model of divided government can shed very useful light on the development and evolution of contemporary institutions for democratic governance.



*Support of Colleagues*

The research and writing of this manuscript took place over many years at several institutions of higher learning throughout the West, and thanks are due to a broad group of colleagues scattered around the world: at the Center for Study of Public Choice at George Mason University, Studieförbundet Näringsliv och Samhälle (SNS), University of Leiden, Nuffield College at Oxford University, University of Rome, University of Bayreuth, University of Southern Denmark, and University of Amsterdam. Many helpful conversations also took place at academic conferences and seminars in Europe, Japan, China, Korea, and the United States. Students at the University of Bayreuth and University of Southern Denmark directly and indirectly helped bring the book to final form through their feedback in courses based on early draft chapters of the book.

George Tridimas and Dennis Mueller carefully read through preliminary drafts of the book and made very helpful comments and suggestions that greatly improved the final version. Toke Aidt, James Buchanan, Mario Ferrero, Klas Fregert, Hans Bernd Schäfer, Gordon Tullock, and Akira Yokoyama also read several preliminary chapters of the manuscript, and provided helpful comments and suggestions. Other colleagues made short comments in conversations about the book that helped clarify my thinking. These include conversations with Cheryl Schonhardt-Bailey, Geoffrey Brennan, Charles Breeden, Bryan Caplan, Mark Crain, Lars Feld, Paal Foss, Georgio Galeotti, Robin Hanson, Rainer Hegselmann, Douglas Hibbs, Arye Hillman, Larry Iannaccone, Sarah Jennings, Gebhard Kirschgässner, David Levy, Arthur Lupia, Iain McClean, Bruce Bueno De Mesquita, Mike Munger, Rob Nelson, Douglas North, John Nye, Elinor Ostrom, Scott Paris, Torsten Persson, Olof Petersson, Roald Ramer, Illia Rainer, Christilla Roederer-Rynning, Pierre Salmon, Bernard Steunenberg, Birgitta Swedenborg, Thomas Stratmann, Yoshifumi Ueda, Stefan Voigt, Viktor Vanberg, Karl Warneryd, Barry Weingast, Stanley Winer, and Ronald Wintrobe.

Thanks are due to these and several other colleagues for their interest, criticism, and support, although they bear no responsibility for the use to which I put their comments and suggestions.. Pamela Cubberly helped transform a series of drafts into forms suitable for circulation and also provided a number of helpful comments. Additional editorial suggestions were made by Jane Perry and the references were carefully checked by Marta Podemska. Scott Paris's encouragement helped carry the project through to completion, although it took many years longer than I expected. Very helpful suggestions were also provided by three anonymous readers for Cambridge University Press.

*Overlap with Previously Published Work*

Material from several of the chapters has been published in academic journals, partly because of the usual pressures of American academia and partly to have the analysis carefully examined by reviewers and editors in Europe, Japan, and the United States:

“From Royal to Parliamentary Rule without Revolution, the Economics of Constitutional Exchange within Divided Governments,” *European Journal of Political Economy* 23 (2007): 261–84.

“Constitutional Exchange in Japan: From Shogunate to Parliamentary Democracy,” *Public Choice Studies* 47 (2006): 5–29.

“Amendment Procedures and Constitutional Stability” (with B. E. Rasch) in *Democratic Constitutional Design and Public Policy: Analysis and Evidence*. (R. D. Congleton and B. Swedenborg, eds.), Cambridge Mass: MIT Press (2006): 319–42.

“Science and History: How Predictable is Political Behavior?” in *Understanding Change: Models, Methodologies, and Metaphors*. A. Wimmer and R. Kossler, Eds., New York: Palgrave Macmillan (2005): 260–69.

“Economic Development and Democracy, Does Industrialization Lead to Universal Suffrage?” *Homo Oeconomicus* 21 (2004): 283–311.

“Mutual Advantages of Coercion and Exit within Private Clubs and Treaty Organizations: Toward a Logic of Voluntary Association,” *Revista de Political Economy* 94 (2004): 47–75.

“A Theory of Menu Federalism, Decentralization by Political Agreement” (with Andreas Kyriacou and Jordi Bacaria), *Constitutional Political Economy* 14 (2003): 167–90.

“Economic and Cultural Prerequisites for Democracy,” *Rational Foundations of Democratic Politics*. A. Breton, G. Galeotti, P. Salmon, and R. Wintrobe, eds. New York: Cambridge University Press (2003): 44–67.

“On the Durability of King and Council: the Continuum between Dictatorship and Democracy,” *Constitutional Political Economy* 12 (2001): 193–215.

Although most of the material taken from the book was substantially rewritten for journal publication, permission to reproduce previously published figures, tables, and some text from the published pieces is gratefully acknowledged.

*What is Entirely New?*

As to how much is truly new in the pages that follow is for readers to judge. Much seems both very new and very old to this author. The theory of governmental reform developed in part I is in many respects a natural extension of the Virginia school of political economy, although the theory departs from and extends that tradition in a number of ways. As a past student and colleague of James Buchanan and Gordon Tullock, I have enjoyed many constitutional and methodological discussions with them over the course of four decades and read many of their books and articles. However, the perspective on the origins of government developed below owes more to Montesquieu than to Hobbes, the enlightenment scholar most stressed in their work. Moreover, none of their research focuses on the king and council template, or has used it as a lens through which to understand long-run constitutional reform and evolution.

Bargaining theories of constitutional design are evident in a good deal of work in political science, law, and economics, but they have not previously been used to provide a unified theory of the evolution of organizational and territorial governance, core features of medieval and modern governance, and gradual transitions from late medieval governance to parliamentary democracy. Indeed, relatively few late twentieth-century political scientists or historians have focused much attention on constitutional reform. Constitutional settings are taken for granted in most mainstream research, so that the effects of different leaders or circumstances can be examined. In other research, institutions are regarded to be cultural phenomena that have little direct effect on policymaking or constitutional reform. This book takes the opposite approach. It neglects the idiosyncrasies of particular leaders and circumstances to focus on general features of organizations, constitutional governance, and reform.

Of those political historians who focus on constitutional developments, most focus on single periods within single countries. None have grounded their narratives on rationales for constitutional exchange and essentially none have done so across countries in a manner that accounts for as much detail of contemporary Western constitutions.

Nonetheless, many of the insights and much about the general approach that seemed very original when first conceived and written, now seem very compatible with older theories and with contemporary work by others in related fields. That the present analysis seems to echo the ideas and words of long-dead scholars is, of course, a mark in favor of the theory and evidence developed in

this volume. The most general and robust conclusions of past scholars have, in a manner analogous to institutions, survived the test of time.

Aristotle's analyses are remarkable in this regard. Although he focused for the most part on pure forms of government—monarchy, aristocracy, and democracy—he did so in order to better understand the more commonplace “mixed” forms of government present in classical Greece.

The reason why there are many forms of government is that *every state contains many elements*. . . For a constitution is an organization of offices [among] which all the citizens distribute among themselves, according to the power which different classes possess. . . There *must therefore be as many forms of government as there are modes of arranging the offices*, according to the superiorities and differences of the parts of the state (*Politics*, Book IV, Part III).

And, although the most famous Greek philosophers disagreed about the nature of an ideal constitution, they agreed that polities based on better constitutions tend to produce more robust governments and better societies than those grounded on less perfect and less robust procedures for devising and enforcing laws. Aristotle, for example, concludes that

The more perfect the admixture of the political elements, the more lasting will be the constitution. (*Politics*, Book IV, Part XII).

Similar conclusions are reached below, although from a much different methodological and historical perspective.

**Part I:**

**Sharing Sovereignty:  
From Autocracy to  
Parliamentary Democracy  
Without Revolution**

## **Chapter 2: Team Production, Organization, and Governance**

In the days before histories were recorded, there were few distinctions between governments and other organizations. Both were evidently largely familial and clanbased. As agriculture emerged and people settled in particular places, the variety and size of organizations and governments tended to increase, and distinctions began to emerge between organizations that could impose rules only on their own members and those that could impose rules on persons outside their organizations. That more activities took place within formal organizations and within territories ruled by governments does not imply that all activities were organized from the top down, as in totalitarian states, nor do the distinctions between governments and other organizations imply that the procedures used by territorial governments had become completely different from those used in other organizations. More people were simply being organized to engage in more tasks, because the advantages of formal organizations with artificial incentive systems had increased for both the leaders and members of organizations.

With such distant beginnings in mind, the analytical history of this book begins with an analysis of the emergence and evolution of formal organizations. All organizations share the property that they are formed to advance goals that can best be achieved by coordinating the efforts of more than one person. All organizations make decisions that focus the organization's resources on particular activities and induce their members to function as more or less productive teams, rather than as unproductive assemblies of individual shirkers and rent seekers. It is these effects that make them "organizations," rather than simply groups of unrelated persons, each doing their own thing. Hunting clubs, farm cooperatives, churches, commercial enterprises, pirate ships, and governments all select projects to undertake and provide internal incentives for undertaking them.

Economics and managerial science analyze solutions to organizational incentive problems. The first half of chapter 2 discusses several natural solutions to internal incentive problems drawing on that literature and extending it to take account of culture. The remainder of the chapter and the rest of part I of this book focuses on the emergence and evolution of standing procedures for making organizational decisions, that is on organizational governance.

To "organize" a team, decisions have to be made about a number of practical details: what is the purpose of the team, how can team production be used to advance that purpose, and what kind of team members make team production cost effective?. After the team is assembled, decisionmaking continues, as purpose, team members, and use of team members are adjusted to

correct initial mistakes and adjust to changing circumstances. There are many ways that an organization can choose its objectives and strategies; although some procedures work better than others, and consequently only a few templates for governance tend to be widely used at a given time and place.

Elinor Ostrom (2005, ch. 8) argues that a very large number of contemporary institutions can be classified using a relatively small number of general characteristics, although great variety may exist in the specific institutions among all organizations. This allows the theory of formal organizational design to be far simpler than the organizations themselves, the specific problems addressed by them, or the environments in which they function.

The present chapter and the next two may be regarded as an effort to provide a somewhat simpler, less fine-grained schema for analyzing institutions (organizations) than the one proposed by Ostrom, although it is very much in the spirit of her work. Of particular importance for the purposes of this book are solutions to the problem of organizational governance based on the “king and council” template. Chapters 2–4 provide a series of explanations for the widespread use of this form of divided government by both “governmental” and “non-governmental” organizations. Chapter 5–8 demonstrate that the king and council organizational template provides a number of ways for parliamentary democracy to emerge gradually from more or less authoritarian territorial governments and without revolutions.

### **A. Formeteurs, Team Production, and the Founding of Organizations**

To begin with, all formal organizations have a beginning; formal organizations are initiated by an individual or group of individuals with particular purposes or goals in mind. A hunting party is to meet at a particular place and time, a barn or house is to be raised, a new product is to be made and sold, trade is to be expanded or contracted, an idea is to be promoted or dismissed, a swamp is to be drained or protected, a village is to be defended or attacked, rights and privileges are to be created, extended or reduced. In this, formal organizations differ from “spontaneous” systems that may be said to emerge without much conscious thought, as with galaxies, ecological systems, or trading networks—although these too may be said to have a beginning, and the latter may also be said to be “piece-wise” the result of intent.

Many formal organizations also have an end. Small organizations often end when their goals have been achieved, as with informal “pickup” sports games and academic conferences. Some organizations only function well because they include particular constellations of personalities and

talents and end when critical members depart. Others end because important incentive or decision problems are not solved and the organization is unable to produce sufficient surplus to sustain itself. Hunting clubs must produce food to be self-sustaining. Churches must attract sufficient donations to maintain their clergy and buildings. Economic enterprises must produce sufficient revenues to pay employees and assure reasonable profits for entrepreneurs. Governments must have sufficient tax resources (and/or loyalty) to retain control of their territories.

New organizations are created every day, because new (potential) advantages from joint enterprises are constantly being imagined. They may be created by single individuals with very narrow purposes in mind, as often assumed by economists about the origins of organizations with profits as their principal goal. Or, new organizations may be formed by groups of individuals or organizations that wish to advance common purposes, as often assumed in rational choice-based analyses of private clubs and treaty organizations and in contract-based theories of the state. Intermediate cases also exist in which a small group organizes a larger one, as when tribal leaders organize a “work gang,” a group of investors create a new production team, or a group of political activists organize a mass demonstration of support or opposition to existing policies. And, cases also exist in which a large group organizes a small one to advance common interests, as when members of a club or cooperative organize small groups to produce services for the cooperative or create an “oversight committee” to manage such activities.

The individuals or groups that found an organization will be called “formeteurs” and the persons recruited by formeteurs will be called “team members.” Except in the very unusual cases in which an entire society is the formeteur, organizations are not be designed to maximize their membership’s or society’s welfare, but rather to maximize that of their formeteur(s). This does not imply that member interests are ignored, only that team members are not the persons to focus on if one wants to understand organizational incentive and governance systems.

### *Why Organizations Are Founded*

Many scholars have remarked that man is a social animal, and that some instinct drives people to form groups of one kind or another. This book suggests, in contrast, that groups come together, because people are often more effective in groups than as unaffiliated individuals. There are often good practical advantages for hunting, farming, building, worshipping, and governing in groups. If an instinct exists, it is because group activities generally advance individual interests.



Team production, however, is not entirely natural for human beings, although it often advances shared interests. A variety of incentive and governance problems have to be overcome for a group of individuals to become an effective team. As a consequence, most productive groups are *organized* in some way.

The left-hand side of table 2.1 illustrates a common incentive problem faced by informal groups that simply share the output jointly produced. The output might be fish caught or fruit harvested from a natural pond or orchard. The “natural cooperative” is assumed to be viable, in that its members produce more jointly than they would have by working alone. The group may be better at finding the best fishing spot or trees to exploit, or the natural cooperative’s sharing of output may simply reduce the risk associated with a bad day of fishing or poor choice of fruit tree. Consequently the exit option is not exercised ( $2 > 1$ ) and group production is undertaken, rather than solitary production.

<b>The Shirking Dilemma for Team Production in Natural Cooperatives</b>				<b>Table 2.1 An Artificial Incentive System as a Solution to the Shirking Dilemma</b>			
	Team Member B				Team Member B		
	Work	Shirk	Exit		Work	Shirk	Exit
Work (A)	3, 3	1, 4	1, 1	Work (A)	R, R	R, R-P	R, 2
Shirk (A)	4, 1	2, 2	1, 1	Shirk (A)	R-P, R	R-P, R-P	R-P, 2
Exit (A)	1, 1	1, 1	1, 1	Exit (A)	2, R	2, R-P	2, 2

The cell entries are output shares, which provide the rank order of subjective payoffs for the team members (A, B). (Utility is assumed to vary directly with rewards or output shares.) The dilemma in the “natural cooperative” case” is that both team members shirk, rather than work.

However, the natural cooperative produces less output than it could have, because its members “shirk” too much, rather than “work,” in equilibrium. “Shirking” may involve a number of behaviors, including low effort at productive activities, high effort at unproductive activities, or various combinations of each. Group members may simply fish from convenient spots and/or take only the low hanging fruit. They may harvest fish or fruit too early or too late. They may take fish or fruit home that should have been turned over to the shared harvest. The assumed equal distribution of the natural coop’s production also tends to limit opportunities for taking advantage of specialization. Fish and fruit may go uncaught and unpicked in difficult locations; fishing nets and

ladders may be under produced, because the group's output is shared equally among all members of the coop, regardless of effort levels, risks taken, or investments made.

Most formal organizations differ from natural cooperatives in that they use "artificial" incentive and recruiting systems. In the case illustrated, team production can be increased by replacing the "natural" system of rewards on the left with the "artificial" system of rewards on the right. Under the artificial reward system, the formeteur promises to pay  $R$  dollars (or units of output) to people who join his organization and work and threatens to impose a penalty of amount  $P$  on those who join and shirk. Those harvesting fish or fruit too early, for example, may be paid less than those who wait until the appropriate time.

A new formal organization is viable, as long as the anticipated net reward ( $R$ ) from being a member of the formal organization is larger than that available from the natural coop (2). The formeteur(s), for example, can promise to pay 2.2 units of output to team members, and threaten to impose a punishment of 1.1 unit of output for shirkers. Solving the shirking dilemma makes team members better off than they would have been in the natural cooperative and in this case generates an organizational surplus (of 1.6 units of output) for the formeteur(s), which provides an incentive to form the organization. In such cases, natural cooperatives tend to disappear as individuals exit to join formal organizations offering greater rewards.

In modern organizations, the most obvious conditional reward structures are those associated with wages, salaries, and promotion. The most obvious threats are wage reductions, demotions, and being expelled (fired) from the organization. In equilibrium, relatively few punishments are imposed by formal organizations, because relatively few team members shirk and because team members often have reasonably attractive exit options. Nonetheless, the threat of punishment remains an important part of artificial incentive systems, because it reduces the private advantage of shirking associated with natural cooperatives.

### *Choosing Reward Systems*

A broad range of team-production and recruiting techniques can be represented as solutions to prisoner's dilemma problems with exit (PDEs) similar to that represented in table 2.1. Coordination problems also exist, as stressed by Hardin (1999), but these are easier to solve than PDE problems, because solutions to coordination games are stable once established. Organizational PDE problems are also more challenging to solve than simple prisoner's dilemma problems, because the solutions

are constrained by exit options, and exit options tend to change through time, partly because formeteurs often compete with one another to attract team members.

An important feature of artificial incentive solutions to PDE problems is that the conditional payoffs of “the intra-organization game” can be manipulated by formeteurs to achieve the desired team behavior, but only within the limits determined by the exit options of team members. Self-interested formeteurs naturally favor reward systems that minimize the overall cost of solving the incentive problems at hand, because this maximizes the organizational surplus available for solving other problems and for advancing other formeteur goals.

The exit options of potential team members, however, create a minimum bound for expected rewards and a maximum bound for expected penalties (if any are imposed). Team members must receive at least as much compensation (adjusted for risk) as is available from other formal organizations and natural cooperatives. At the hypothetical extreme of what economists call perfect competition, exit options are so great and easy to realize that each team member has to be “paid” his or her full contribution to team production. As exit options become less attractive or more costly to realize, smaller rewards can be used to retain team members. In the extreme case of teams composed of persons without exit options (slaves), rewards can be set at subsistence levels and punishments used to encourage work in every case in which penalties are more cost-effective than rewards.

From the perspective of formeteurs, the ideal reward system aligns the interests of team members with those of the formeteur(s) at least cost in the circumstances at hand.

## **B. Formeteurs, Culture, and Organizational Opportunities**

In Schumpeter’s (1934) and Kirzner’s (1978) terms, a formeteur has, creates, or recognizes organizational opportunities that others do not have or cannot see. Consequently, “innovation,” “foresight,” and “boldness” are often associated with organizational leadership along with exceptional ability to recruit and motivate a team. Formeteurs may also be said to be less risk averse than others (Knight 1921) insofar as they are more willing to accept the risks associated with launching new enterprises. Formeteurs, however, differ from the entrepreneurs of classic economic models, because they form organizations, rather than engage in price arbitrage or product innovation alone. Formeteurs cannot be “loners,” although they tend to have unusual motivational skills and organizational insight.<sup>3</sup>

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<sup>3</sup> It should be acknowledged that many new organizations fail, which implies that this formeteur insight tends to be quite imperfect.

Organizational founders are often “charismatic leaders,” who can easily persuade team members to accept their direction. Such persons can solve many of the incentive problems of team production by encouraging personal and organizational loyalty. They induce team members to internalize various “duties,” such as working hard to advance the formeteur’s and “their” organization’s interest. Here, one can imagine the charismatic founders of fishing clubs, pear harvesting coops, and cherry-picking firms encouraging team members to “pull hard on the net,” “climb to the highest branch,” and “not miss anything.” Less skilled or naturally charismatic formeteurs will require more generous and sophisticated pecuniary reward systems to accomplish similar results, which is, of course, part of the reason that formeteurs tend to be relatively talented at assembling and motivating people.

If team members can be induced to work hard at advancing their organization’s goals simply because it is “the right thing to do,” reward systems can be simpler and in many cases less generous. When an organization’s internal culture causes individual members to feel worse off when they act in a manner that conflicts with organizational goals, even when his or her performance cannot be observed by others, monitoring efforts can be reduced. When team members are induced to feel loyal to the organization, subjective exit costs increase, which allows smaller rewards and larger penalties to be used to solve the organization’s internal incentive problems.

It is therefore not surprising that farming cooperatives, private firms, religious groups, and roving bandits all attempt to build team loyalty within their organizations and to promote other internal norms that reduce shirking and increase “team spirit.”

Efforts to develop and support an internal organizational culture may also indirectly support or produce complementary community-wide norms, particularly if several organizations in the same community promote similar internal norms. If team members prosper and take their internalized organizational norms home at the end of the workday, their “corporate norms” may be taught to children and friends. Such norms may also indirectly help solve other coordination, public goods, and prisoner’s dilemma problems among families and friends and within the community at large. Moreover, if some potential team members (employees) are easier to motivate with nonpecuniary rewards than others or are intrinsically more motivated to advance organizational goals, team production costs can be reduced by recruiting such “honest, hardworking team players,” which further encourages the spread of corporate norms in the communities from which team members are recruited.

### *Culture and Organizational Opportunities*

It bears noting, however, that not all norms or propensities to cooperate provide opportunities for formeteurs. A community that supports a “work ethic” requires fewer formal organizations and less sophisticated artificial incentive systems within its organizations, because its informal reward and punishment systems will solve many team production, coordination, and rent-seeking problems. Members of natural cooperatives in such cultures are encouraged to “show up” and “do good work” by their peers within the organization and also by their friends and families (Congleton 1991b). Other norms may reduce the effectiveness of artificial reward systems. For example, team members may cooperate to “escape” from prisoner’s dilemma games designed by formeteurs, such as competitive piece-rate schedules, with coordinated work “slowdowns” and “sick-outs.” Other internal norms that predispose team members to work, rather than shirk, also simultaneously reduce organizational costs and the need for formal organizations. Simulation studies by Axelrod (1986), Boyd and Richerson (1992), and Vanberg and Congleton (1992, 2001) demonstrate that strategies of conditional cooperation can be privately advantageous for individual team members in settings in which exit is possible and organizations last more than a few periods.

Both norms that reduce the need for artificial incentive systems and norms that make artificial incentive systems more difficult to design make formal cooperatives less viable, which reduces formeteur opportunities for creating formal organizations.<sup>4</sup>

A niche for formal organizations, nonetheless, remains unless the norms of conditional cooperation solve all coordination and team production problems, or completely undermine all systems of artificial incentives (Ostrom, Walker, and Gardner 1992). For example, 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 team and community 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 externality and coordination problems that must be addressed. Active management and active rule enforcement are often necessary to solve team production problems.

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<sup>4</sup> See Congleton (1982) for a relatively simple rational choice model of organizational inertia and bias.

This niche tends to be increased by other culturally transmitted values that allow formeteurs to economize on rewards by solving team production and coordination problems with praise, status, and informal perks for “outstanding work,” rather than with (or in addition to) money or physical output rewards. Community norms may encourage persons to keep their promises, be punctual, and follow instructions. Indeed, formeteurs may also be informally rewarded for founding organizations with additional status or opportunities within some communities. Here one might note the number of plaques, ribbons, medals, and certificates handed out to successful formeteurs for “outstanding achievement” by nonprofit organizations, such as territorial governments, military civic organizations, schools, and profit-maximizing firms.

### *Culture Somewhat Reduces the Convergence of Reward Systems*

Whenever a variety of methods can be used to achieve the same end, formeteurs will use the combination that is least costly to implement, other things being equal. This common economic interest of formeteurs generates considerable convergence among organizational reward systems. Complete convergence in reward systems does not occur, however, because not all motivational devices are equally available to or subject to manipulation by all formeteurs.

Some organizational goals are better aligned with preexisting local norms than others, which implies that some organizations have larger pools of potential team members that are “naturally” predisposed to promote their goals than others. For example, during the medieval period in Europe, it is clear that religious orders were able to attract very talented members with relatively small pecuniary rewards, because so many persons in their communities were already interested in advancing the same religious goals. Similarly, in the nineteenth and twentieth centuries, formeteurs that created new politically active groups to advance nationalistic, economic, or ecological goals could often draw from relatively large pools of patriots, economic liberals, and greens to write books and give speeches, staff their interest groups, and support their political parties.

Culturally favored organizations can assemble more effective teams at less cost than organizations with other goals. Conversely, the willingness of “customers” to pay for the services provided by organizations also varies somewhat, which allows some organizations to provide stronger pecuniary rewards than others. As a consequence, the feasible mix of pecuniary and nonpecuniary rewards varies somewhat among organizations. Investment bankers are generally paid more than fishermen and pear pickers.

The best feasible combination of conditional rewards, consequently, tends to be more similar among organizations that produce similar services than among those producing different ones. For example, contemporary religious organizations and governments rely extensively on selection, internal values, culture, and financial rewards—roughly in that order—to motivate their team members. Commercial organizations also attempt to recruit team members who are easy to motivate, but usually rely more extensively on conditional pecuniary rewards (hourly wages, bonuses, sales commissions, stock options, and promotions), than on internal culture to solve their team production problems.<sup>5</sup>

### **C. Cultural and Economic Rationales for Organizational Conservatism**

Overall, the analysis above demonstrates that reward systems are complex, which provides a good reason for formateurs to adopt “off the shelf” reward and recruiting systems. Both the templates chosen for reward systems and the teams assembled reflect the aims and constraints of their founders, rather than history or broad collective objectives, *per se*. The constraints include technological and cultural factors, which are not entirely predictable. Although formateurs can influence both technological and cultural developments, neither is completely within their control, because both are consequences of complex networks of social relationships and dynamics that are beyond the complete understanding or control of any single person or organization.

Acknowledgement of the partly “spontaneous” and unintentional nature of productive internal and external cultures has implications for the formateur’s choice of organizational design. It implies, for example, that new pecuniary reward systems and new recruiting methods may have unintended consequences on an organization’s ability to attract and retain productive team members. For example, the evidence surveyed by Frey and Jegen (2001) suggests that increases in explicitly conditional forms of motivation often reduce (crowds out) self-motivation. In principle, the unintended effects of changes in reward systems on internal culture can be positive or negative, but even if the unintended effects (prediction errors) are symmetrically distributed around zero, rather than biased toward undermining the organization’s supporting culture, risk aversion on the part of formateurs implies that fewer organizational experiments take place.

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<sup>5</sup> See Iannaccone (1992, 1998) or Wintrobe (2006) for overviews of how norms of various kinds can be encouraged (or exploited) in order to solve free rider and coordination problems in organized groups. Most economists recognize the importance of incentive systems within organizations, but tend to focus only on pecuniary ones. See, for example, Holmstrom and Milgrom (1994).

“Institutional conservatism” in such cases is an entirely rational response to the problem of “unanticipated consequences” by risk-averse formeteurs (and their successors). “If it ain’t broke, don’t fix it.”

### *Economic Support for Institutional Conservatism*

Rational institutional conservatism is further supported by advantages associated with being “conventional.” Stable internal routines, theories, and norms can be passed on to successive generations of team members at a relatively low cost, as current team members teach new members the methods for getting along and succeeding within the organization. The use of routine “off the shelf” methods of reward and assignments of responsibility within an organization allows personnel to be easily shifted among teams within large organizations. The use of commonplace reward systems allows new team members to be recruited from other organizations and employed with lower training and acculturation costs than is possible when differences among internal reward systems are large.

In settings in which a number of organizations compete to attract the services of team members, team members will naturally tend to join the teams offering the highest (risk-adjusted) rewards and exit from those providing the lowest (risk-adjusted) rewards. Organizations that offer too little to current and potential team members will not be viable, because they will not be able to retain or attract team members. Conversely, teams cannot promise to pay too much, because the system of rewards cannot be greater than the team’s total production without reducing the viability of the organization. Competitive pressures, thus, reinforce other practical advantages associated with the use of conventional reward systems. The greater is the competition for team members, the narrower is the range of feasible reward systems.

Such economies of conventionalism reinforce tendencies for convergence of internal incentive regimes and provide additional support for institutional conservatism and stability. Together, the common interests of formeteurs and competitive pressures imply that very similar solutions to intra-firm incentive and governance problems tend to be widely used in culturally linked regions and applied for long periods of time.

The convergence and stability of reward systems do not, however, imply that every formeteur regards his or her organizational form to be the best that can be imagined or that formeteurs are extremely risk averse. Nor do they imply that the results are socially optimal in some sense. For example, excessive conservatism may be induced by a prisoner’s dilemma–like social dilemma that



increases the stability of prevailing practices beyond optimal levels. Individual formeteurs may not be able adopt more “efficient” practices without losing team members or customers to their more conventional rivals, even though all formeteurs and team members would be better off with revised practices.

With or without such social dilemmas, however, it remains the case that the formeteurs adopt the most cost-effective reward systems that are feasible for them, and that considerable convergence among reward systems tends to take place. Stable patterns of rewards simply imply that the anticipated cost of significant reforms exceed their benefits for formeteurs, given prevailing practices and norms in the communities in which the organizations operate. Fishing clubs will use similar nets to catch similar fish in similar places. Pear harvesting coops will use similar ladders and baskets. Cherry picking firms will use similar harvesting techniques and pay similar wages to their employees based on similar performance criteria.

#### **D. Why Organizations Have Governments**

Institutional conservatism and convergence do not imply that experimentation ceases or that organizations become completely rigid, although they do imply that standing routines tend to be relied on, experiments tend to be relatively small, and the routines employed tend to be similar within organizations pursuing similar goals.

As external circumstances change, organizations that have routines for adjusting their team’s production to take advantage of the new circumstances will tend to do better than organizations that do not. For example, changes in the location of fish or fruits caused by seasonal or long-term changes in weather may require fishing clubs, pear-harvesting cooperatives, and cherry-picking firms to change their methods of team production. Seeking new fish may require new fishing gear, new times of day for fishing, or new fishing strategies. Harvesting new fruits from new orchards may involve larger or smaller trees, or heavier, lighter, more perishable types of fruit, and more travel. Changes in the supplies of particular ores or demands for particular metals may similarly induce blacksmiths and smelters to search for new sources of ore and to refine their alloys.

The fact that various forms of team production become more or less viable as external circumstances change has a number of important implications about organizational design, one of which is relevant for the purposes of the first half of this chapter and another of which is important for the remainder of the book.

Regarding the first, dynamic circumstances provide another explanation for the use of complex reward systems. Inducing changes in team production often requires changing the organization's reward system. Multidimensional reward systems can more be easily adjusted to encourage personnel to shift among tasks than single-dimensional compensation schemes, because there are more margins for adjustment and it is unlikely that all the dimensions of compensation are constrained by useful internal norms. The pear-harvesting cooperative and cherry-picking firm may provide long-distance harvesters with somewhat generous travel reimbursements (new shoes), better equipment, or create new prizes for those who have walked the most miles in the service of their organization. Such rewards may encourage team members to volunteer for work in new locations, without undermining other useful aspects of family-, seniority- or loyalty-based reward systems.

Regarding the second, it bears noting that organizations with flexible reward systems can induce their teams to be more effective in new circumstances only if they have procedures for recognizing new circumstances and adjusting their methods of team production to take advantage of the new circumstances. A fishing club, pear harvesting cooperative, or cherry picking firm that simply returns to the same pond or orchards after all the fish and fruit are gone will simply not survive. They must also be able to recognize innovations in "best practices" in order to take advantage of innovations in reward systems and team production.

Organizations that are able to detect relevant changes in circumstances and make modest adjustments to their standing policies tend to be more successful than those that cannot. They survive in more environments, because they are quicker to adjust to changing circumstances and better able to make adjustments than those without routines for recognizing new circumstances and responding to those changes. In other words, durable organizations have governments, because the present is not entirely stable, the future is not completely knowable, and the best methods of team production vary with circumstances.

Paradoxically, survivorship, institutional convergence, and rational institutional conservatism imply that organizations cannot be entirely rigid in the medium and long term, except in completely unchanging and understood circumstances.

## **E. Organizational Governance**

The standing procedures for making policy decisions within organizations have attracted far less attention by economists and other rational choice analysts than have the internal incentive systems analyzed in the first half of the chapter. For example, Williamson's widely read books and articles on

corporate governance (1967, 1996, 2002) implicitly assumes that the institutions for choosing policies are already in place, essentially automatic, and well-functioning. The same can be said about Alchian and Demsetz' (1972) analysis of team production, Vicker's (1985) analysis of delegation, and Laffont and Tirole's (1993) game-theoretic analysis of relationships among firms and between government regulators and firms.

A partial defense of that neglect is that an organization's government is often an instance of team production and delegation. In most cases an organization's standing policies are jointly produced by several team members that have been delegated authority to make various policy decisions. Information is collected about internal and external circumstances, the information analyzed, alternatives evaluated, and decisions made. In only the simplest of organizations and circumstances is all this done by a single individual. As a consequence, those participating in organizational governance normally have "artificial" incentives that are largely determined by the organization's standing system of rewards, because the usual problems of team production have to be overcome to create an effective organizational government.

However, just as an organization is more than an incentive system, its government is more than just another team.

The "outputs" of an organization's government are very different from those of other teams. Its outputs are decisions that substantially create the organization itself and revise it through time. It determines whether teams will be organized to pick cherries, pears, or apples. Once teams are organized and production is underway, it determines whether to continue or not; and whether to change direction or not. A pear harvesting cooperative may switch to grapes or olives. A fishing firm may shift from fishing to shipping, and, if it does so, the policy choices of its governing body will substantially determine which ships head to which port cities, and who and what is on board its ships. The decisions of the ruling body of a regional government determines what will be taxed, who will collect the taxes, and also how future decisions about taxation will be made.

As a consequence, there are informational, bargaining, and collective choice aspects to organizational governance that are absent or much smaller for other teams within large organizations.

*“Natural” Organizational Governance*

In most cases, formeteurs also choose standing procedures for making and revising policies at the same time that they create their new organizations, because they recognize that their initial policy decisions are provisional, rather than final.

The “natural” first form of organizational governance is the one (implicitly) assumed by most economists and also by many political theorists. Formeteurs may simply retain their initial authority to make and revise all major policy decisions after their organizations are up and running. Such “authoritarian” decisionmaking procedures have many advantages for formeteurs and their organizations. Formeteurs often have a superior understanding of organizational possibilities, which justifies their initial investment of time and attention to assemble a team and devise methods for advance particular goals. Formeteurs know their own goals better than others are likely to and normatively have leadership skills that allow them to form and motivate groups at lower costs than others. Leadership skills often include a relatively large informational base and the ability to persuade others that it is in their interest to defer to the formeteur’s direction.

In the medium and long run, however, as demonstrated below, it is often in the interest of formeteurs to relinquish part or all of their initial control over their organization’s policies. There are cases in which sharing policymaking authority can improve organizational governance, and many other cases in which limiting or sharing their policymaking authority can advance other formeteur goals. Voluntary transfers of policymaking authority are partly driven by informational and time allocation problems that emerge as an enterprise increases in scale and complexity and partly by other practical advantages that can be realized by shifting and trading authority within their organizations.

For example, formeteurs of contemporary commercial enterprises often give up part of their control over their organization in exchange for investments by those who purchase voting shares. By “going public,” formeteurs become “shareholders in” rather than “owners of” their enterprise. Such trades of authority for money often increase the resources available to their organizations, albeit at the cost of reduced control over their organizations. Similar transactions often took place between European kings and parliaments in the period between 1400 and 1900, as developed below in Part II of the book, and analogous transactions took place between local rulers and “free towns” in the late medieval period. No threats of violence were necessary for such shifts of authority to occur.

It bears noting that both delegation and markets for authority tend to produce divided forms of organizational governance. Authority for making policies may be shared among formeteurs and other stakeholders or specific policies may be under the control of different subsets of an organization's government. In many, perhaps most, cases the form of divided government adopted is a variation of the "king and council" template for governance. The king and council template divides policymaking authority between a chief executive (the king) and a committee of more or less equals (a council, board of directors, or parliament), who jointly make policy decisions.

The remainder of this chapter focuses on the informational advantages of governance based on the king and council template. Other advantages and opportunities for trading policymaking authority within that template are developed in chapters 3–6.

## **F. The Formeteur-Ruler's Informational Problems and Institutional Solutions**

Consider the case in which a single formeteur initially chooses to run his or her organization as an autocrat. This is not the only possible type of formeteur or initial form of government, but it is a natural place to start and it is widely assumed in rational choice analyses of economic and political institutions. The formeteur is clearly in the best position to know his or her own interests, and has a reasonably clear idea about how an organization can be created to advance those interests. As a single actor, he or she avoids the collective choice dilemmas noted by Olson (1965) and the potential intransitivity problems of collective decisionmaking noted by Arrow (1963).

Wintrobe (1998) argues that all such autocrats face several kinds of information problems, many of which are consequences of their control over organizational rewards and punishments.

First, an autocrat faces the same information problems as an ordinary person. An autocrat must decide how much information to gather about every dimension of choice and every causal chain that may affect his or her assessments of alternatives. He or she must decide which information sources are reliable and how much of the information gathered to share with others. A formeteur, however, has greater need for accurate information than other persons in his organization, because the scope of an authoritarian formeteur's policymaking authority is initially much wider than that of other members of the organization. There are alternatives that must be accurately assessed if he or she is to make policy decisions that effectively advance his or her own interests. In unstable settings, autocrats will also require useful information about changes in the internal operation of his or her organization and in the external environment in order to make effective use of the team assembled.

The organization itself may also be revised, as its weaknesses and strengths and new opportunities are revealed through time.

Second, an autocrat confronts a series of information problems that are consequences of his or her authority to allocate organizational resources and to adjust the internal system of rewards. The information provided by others within the organization tends to be intentionally biased whenever there are potential benefits from manipulating the autocrat's assessment of alternatives or people within the organization. Personal careers can often be advanced by exaggerating one's loyalty and performance relative to other rivals within the organization. "Cherry polishers" do not simply seek the boss's favor, but hope to profit from that favor. Wintrobe (1998: ch. 2) refers to this aspect of a rule maker's informational problem as the "dictator's dilemma." Persons who assure the autocrat that he or she is right in every case may increase the ruler's confidence (and gain his or her ear), but will not increase the accuracy of his or her policy decisions.

The larger the organization and more complex the goals and operating environment, the more difficult such informational problems tend to be and the more costly are mistakes that could have been avoided with better information. Two quite different informational settings are analyzed below.

### *Why Well-Informed Formeteurs Benefit from Advisory Councils*

Consider first a shrewd fairly well-informed formeteur-ruler with unbiased expectations about the consequences of alternative policies and therefore about the relative merits of policy alternatives. Such formeteurs will not make systematic policy errors and will choose policies that maximize the (average) effectiveness of their organizations and, thereby, their own expected utility. Yet a formeteur, like any other person, will economize on information and devote his time and attention to collecting and processing information only up to the point where his expected marginal benefits equal its marginal cost. Statistical theory implies that the smaller the data set on which estimates are based and the less sophisticated and thorough the analysis, the greater the errors tend to be, other things being equal.

In most cases, the sum of the information possessed by an organization's team members includes much that is not and cannot be known by even a well-informed formeteur. Team members, for example, often know a good deal more about the specifics of production than the formeteur. Members of a pear-harvesting coop or cherry-picking firm often know details about particular orchards or trees that the formeteur does not. For example, pears or cherries on the northeast side of particularly trees may be juicier than those on the northwest side at some locations or during

some times of the year. Taking account of this information would improve harvests and/or increase profits, although that information cannot be accessed directly by the formeteur.

In small organizations, useful information and recommendations may simply be collected from all team members. In larger organizations, an “advisory council” may be recruited by choosing members randomly from the organization’s team (or citizenry). Such “citizen advisors” tend to be less informed overall than the formeteur-ruler, because such persons lack an encompassing interest in the organization. Advice from such councils, however, may still be useful, because team members have different personal experiences and expertise. Insofar as the information (samples) of the formeteur and members of the advisory council are independent of one another, their predictions about future events are also independent and may be approximately unbiased. Elementary statistics implies that an appropriately weighted average of several unbiased estimates is a better estimator (more accurate) than any single estimate. There are also many cases in which the unweighted average or median estimate of a group is more accurate than the estimate of the member with the largest data set. This information-aggregating effect implies that a council of non-expert advisors that makes recommendations on the basis of majority opinion or consensus can be a cost-effective method of assessing the merits of alternatives, because it produces relatively accurate median forecasts and recommendations.<sup>6</sup>

In areas in which specialized knowledge is useful, the formeteur can improve the quality of the advice obtained by assembling a panel of especially well-informed individuals, whose more complete understanding of the organization and its operating environment makes their forecasts less prone to error than the typical member of the organization. Such expert councilors may have a comparative advantage at gathering and processing information relative to other team members for many reasons. They may simply have greater talent for assembling and processing information, or may have devoted much time and energy to acquiring large information sets and skills for analyzing them. Such experts, by definition, have relatively greater speed or accuracy as information processors

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<sup>6</sup> This aggregation effect of the use of majority rule is often referred to as the jury theorem or Condorcet’s jury theorem. Nitzan and Paroush (1985), Wit (1998), McLennan (1998), and Congleton (2007b) shows that a council that uses majority rule to select recommendations tends to be far less error prone than individual members of the council. Large committees would make essentially no mistakes if individual members are even slightly more likely to be right than wrong in their recommendations and voted on the basis of their private information.

That consulting with a “council of wise men” can improve decisionmaking is, of course, not a new idea. The idea that a committee of experts possesses more information than a group of ordinary people (who often possess more information than a single expert) is mentioned, for example, by Aristotle in book 3 of *the Politics*, which has been widely read for centuries.

than the average member of the organization and can also provide the formeteur with more accurate assessments of the merits of alternative policy decisions.

For example, the formeteurs of the pear-harvesting coops and cherry-picking firms might send out “orchard spotters” to assess the quality of the fruit available at various orchards in the area on a particular day. A committee of experienced fruit harvesters may listen to the spotter reports and offer their informed opinions about which orchard is likely to provide the best harvest. Similarly, the formeteur-ruler of a trading enterprise that wants to establish a new trading post may direct his advisors to sample the opinions of well-traveled persons, and to recommend a few places where a trading post can profitably be established. The leader of a team of roving bandits may send out scouts to bring back information about the availability and cost of acquiring goods in new territories. His “war council” may use that information to make suggestions about where and when to launch the team’s next raids.

### *Competition for Membership in Advisory Councils*

The value of the information and advice produced by advisory councils will often be far greater than the cost of the advisory team’s compensation, because the reward systems for such information gathering and processing teams—advisory committees—will normally be a combination of status, privileges, and money, roughly in that order. Many advisors will be pleased to provide free information to the formeteur, simply because they value the approval and thanks of ambitious men and women. And, of course, advisory councils can be quite small, which tends to enhance the prestige associated with membership.

Team production of advice often produces economies in information gathering and analysis that are analogous to other forms of team production. Recruiting the right men and woman to such teams can also increase an advisory council’s productivity. Comparative advantage at information collection, processing, and advice giving can be increased through various artificial incentive systems.

The formeteur may, for example, construct contests for council membership that reward analytical skills and policy-relevant information acquisition with relatively high status and/or salaries. Contemporary research suggests that such contests can be extremely effective methods for inducing investments in useful information and analytical skills. The sum of the investments by the purchasers of lottery tickets is normally greater than the sum of the rewards given out, which is, of course, what makes lotteries profitable (Tullock 1980, Hehenkamp et al. 2004). Compensation in the form of



*positional goods* can also be quite inexpensive for the proprietor, yet encourage substantial efforts by prospective councilors (Tullock 1965, Hirsch 1976, Frank 1985, and Congleton 1989). Moreover, being councilor to a successful formeteur may also produce new “consulting” opportunities as well as status through reputation effects.

Thus, one widely used informational technology for collecting and filtering information is the advisory council. This solution requires recruiting and motivating a team that specializes in collecting and processing information that is useful for the formeteur’s decisionmaking. Such teams may also be charged with proposing new policies that may advance the formeteur’s interests. In such cases, the advisory council is given some agenda control over the alternatives considered by the formeteur-ruler.

### *The Dilemma of Experts*

Motivational problems for council members are fairly limited in environments in which the proprietor is sufficiently informed about policy consequences to make his or her own unbiased estimates of the facts or policy consequences. In such cases, the formeteur-ruler can reject obviously manipulative estimates and recommendations by the council (and individual council members) as implausible “outliers” and punish the conspirators for their “disloyalty,” that is, for placing their own interests above his. A cherry spotter’s claim that the “the cherry trees in the next village are a three hundred feet tall with tons of cherries on every branch” can easily be rejected by a formeteur that knows something about cherry trees, without traveling to the recommended village.

The motivation problems become more difficult as one shifts from settings in which the formeteur-ruler and councilors have small samples of essentially complete information to ones in which the formeteur and potential councilors all remain completely ignorant about some relevant dimensions or possible consequences. For example, the formeteur may not have traveled or studied extensively and so may be largely ignorant about orchards, trading posts, and rival bands of bandits in other territories. His potential councilors may include individuals that have traveled more widely and know more languages, but even such sophisticated travelers will not have visited every possible orchard in every possible territory. Some kinds of fruit trees will remain entirely unknown. In such circumstances, completely unbiased estimation about the best type of orchard or method of harvest may not be possible for the formeteur-ruler or his councilors (Congleton 2001, 2007).

Knowledge problems of this sort increase the potential advantage of additional information, but also increase the risk of manipulation. To profit from the advisory councils in areas in which the

formeteur-ruler is essentially ignorant, the organization of the council must overcome the “dilemma of experts,” the difficulty of taking advice from knowledgeable persons whose information cannot be readily appraised by the person receiving it and which may or may not be biased.

The dilemma of experts would not be a problem if members of the advisory committee were indifferent about the formeteur’s subsequent policy and personnel decisions, and so simply passed on their best advice, but this is not always the case. A few orchard spotters may prefer one kind of fruit or location to others. Bandit scouts and war councils may have grudges against particular communities or persons. Trading-post experts may have friends who own real estate in one of the areas of interest or prefer some climates to others. Such personal interests may cause advisors to provide overly optimistic assessments of some opportunities and overly pessimistic ones about others that are less personally advantageous.

In the previous “rational expectations” case, the formeteur had his own independent and unbiased estimates that could be used to reject opinions and advice that were clearly outliers, but in settings in which ignorance, rather than small samples, is the main informational problem, he does not. Relatively short-term forecasts and advice can often be directly checked as events unfold, but even short-run decisions based on bad advice can be disastrous for an organization during difficult times.

### *Beyond the Kitchen Cabinet: Advantages of Representative Advisory Councils*

A common method of addressing the dilemma of the expert in settings in which significant formeteur-ruler ignorance exists is to assemble a small loyal group of advisors—a council of loyal wisemen, who have demonstrated that their interests are aligned with those of the formeteur and whose recommendations on past matters have been sound. In small- and medium-sized organizations, such advisors might, for example, be assembled from the formeteur’s family members, friends, and long-term employees whose interests are often well aligned with those of the formeteur. Such “kitchen cabinets,” however, may exhibit considerable ignorance about matters beyond their own organization (or the royal court).

A council whose membership extends beyond the organization has informational advantages over kitchen cabinets, because “outsiders” have a larger sample of information and include more kinds or dimensions of information than “insiders” could or would be inclined to assemble on their own. The more extensive information sets of councils of outsiders reflect their broader range of talents, interests, and experiences. Many of these informational advantages reflect systematic

differences in backgrounds (education, profession, and/or family) that can be easily recognized by the formateur, while others reflect chance events that provide outsiders with unique experiences and acquaintances (travel, talent, and friends) that cannot be so easily appraised.

The informational advantages of a council of outsiders, however, come at the price of greater motivational problems. In many cases, biased (manipulatory) advice can reduce the effectiveness of outsider councils to levels below that of insider councils. This partly explains why kitchen cabinets are so common, especially in cases in which outside information is not particularly valuable or can be acquired without relying on outsiders.

In cases in which outside information is especially valuable and tends to be available only from outside experts, an advisory council that includes outsiders can provide more useful advice than a “kitchen cabinet,” even if agency problems cannot be completely eliminated. For example, both our illustrative pear-harvesting cooperative and cherry-picking firm may benefit from the advice of a panel of agronomists and marketing experts, even if their advice cannot be entirely trusted.

One institutional method for reducing the agency problems associated with outsider councilors is to assemble “representative councils” with predictable biases. By including members with opposing personal interests, one hears arguments on all sides of an issue, and can be reasonably assured that points of agreement are unbiased assessments. The members of such councils can be assembled, for example, by having various economic and ideological interest groups (regional authorities, guilds, landowners, banks, labor unions, clergy, and so on) propose members for the advisory council. The problem of manipulation (biased advice) can be further reduced by including insiders as well as outsiders on the advisory council, which allows outsider assessments to be evaluated by insiders before being applied. Such “representative” councils allow that policy assessments to be based on a broader information base than possible from groups of insiders, while at the same time increasing the likelihood that the median or average of the analyses and advice given is well informed and unbiased.<sup>7</sup>

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<sup>7</sup> Gilligan and Krehbiel (1989), Krehbiel (1991), and Banks and Weingast (1992), among others, provide a careful game-theoretic analysis of the informational aspects of heterogeneous committees and agencies. Although their main focus is essentially the opposite of that explored here, their analytical results are consistent with the arguments developed above, namely that advisory committees function best when all interests are represented. See Balla and Wright (2001) for a useful overview of this literature as it relates to advisory committees and for evidence that such representative advisory committees are used in contemporary governments.

The advice of such representative councils may still be problematic if the council as a whole has policy interests that differ systematically from those of the formateur-ruler.

## **G. Why Well-Informed Formeteur Partnerships Employ a Chief Executive**

The informational problems of a formeteur-ruler and advantages of advice from committees suggests that organizations founded by small groups of formeteurs may be better able to make policy decisions than those founded by a single formeteur. Formeteur partnerships can function as a committee of experts by themselves, and so they can potentially draw on more information and use it more effectively than an otherwise similar single formeteur. It is thus not surprising that many organizations are founded by small teams of formeteurs, who form partnerships of various kinds. (Our illustrative pear-harvesting cooperative may have been formed in this way.)

Even a small group of formeteurs, however, may not be able realize their potential informational advantages, because the individual formeteur-partners lack a fully encompassing interest in their organization's operation. Each partner receives only a fraction of the organization's surplus or profits. As a consequence, each tends to under-invest in their joint enterprise. For example, each member farmer of a small pear-harvesting cooperative tends to be more interested in his or her own orchard's success than in the cooperative's overall production and profits. As a consequence, the partners collectively under-invest in the cooperative's activities, which reduces their partnership's ability to reduce member costs and increase their sales by negotiating with suppliers or running joint advertising campaigns.

Formeteur-partnerships cannot always solve their informational and managerial free-riding problems by simply ruling as a committee.<sup>8</sup>

A natural solution to the "committee government dilemma" faced by formeteur partners is to delegate responsibility for managing their organization on a day-to-day basis to a single person, a chief executive officer (CEO), senior partner, king, high priest, or prime minister. Such CEOs directly participate in the day-to-day execution of policy and so acquire relatively complete and detailed knowledge of the process of implementing policy within the organization. The CEO's informational advantage allows him (or her) to understand the effects of alternative day-to-day policies better than other members of the partnership, and so is able to make more-informed decisions. In this case, however, the "king" (CEO) will serve at the pleasure of the "council" (formeteur partners), who will retain considerable policymaking authority for themselves, including veto power over major initiatives.

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<sup>8</sup> Such free-rider and agency problems partially explain the existence of partnership law, which attempts to assure that partners do their duties and receive what is properly due to them. Partnership law extends back to at least Roman times (Weber 2003).

The previous analysis of reward systems implies that the formeteur-partners will use cost-minimizing combinations of pecuniary and nonpecuniary rewards to align the interests of their chief executive officer's with formeteur interests. The effectiveness of that reward systems can usually be improved by selecting CEOs who are relatively easy to motivate and have the talent to be effective managers. In other words, the chief executive is chosen only partly for his or her managerial ability. His or her own norms and desire for approval, respect, status, fame, and financial resources are equally important, because these reduce the cost of solving principal-agent problems.<sup>9</sup>

Selection procedures are also important because selection procedures can also induce competition for the post of CEO. Insofar as the selection process sufficiently open and CEO compensation is sufficiently generous to produce competition for the post of chief executive, many talented individuals will invest in acquiring the skills and knowledge to be an effective CEO. The latter also provides some redundancy in advice and information sources, which further reduces monitoring costs for the council of formeteur-partners.<sup>10</sup>

For such reasons, organizations founded by small groups of formeteurs also tend to use the king and council template for organizational governance, although formeteur-partners will adopt a quite different initial distribution of policymaking authority than that used by a single formeteur. The council will normally retain broad policymaking authority, including veto power over major policy changes and also over changes in the organization's distribution of policymaking authority. They will also retain the authority to replace their current chief executive officer when selection errors are made and/or when their reward system fails to align the CEO's interest with their own.

### *Delegation to a "King and Council" by Very Large Groups of Formeteurs*

When a large group of formeteurs (or organizations) forms a new organization, day-to-day management and considerable policymaking authority may be delegated to an organizational government for more or less similar reasons.

It is very costly for the members of large cooperatives, stock companies, partnerships, and polities to meet and debate policy alternatives every time a decision has to be made. Such meetings

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<sup>9</sup> Brennan and Hamlin (2000) discuss how selection can be used to find the right persons to fill positions in organizations in which monitoring is difficult and contracts are incomplete. Their discussion addresses problems in democratic design, but their logic clearly applies to other organizations as well.

<sup>10</sup> It bears noting that modern elections for presidents require candidates to reveal their policy preference, personal propensities, and managerial talents to the persons selecting them. Contests for the CEOs of large organizations are similar in many respects, although less public.

are very time consuming and inconvenient. Moreover, informational “free riding” tends to be a greater problem for large groups than for small ones. Consequently, one of the first collective decisions by the founders of a large cooperative or small town is normally to delegate significant policymaking authority to a cooperative or town government.<sup>11</sup> As in other organizational choice, there will be templates for cooperative and town governance that have survived the test of time, and large groups of formeteurs will normally choose from among preexisting forms, rather than invent a new one whole cloth.

For reasons similar to those developed above for the single formeteur and small number of formeteur cases, large founding groups are thus likely to adopt some version of the king and council template: an chief operating officer and board of directors, a mayor and town council, a president or prime minister and a parliament. Such forms of government tend to produce better policy decisions than others, including meetings of the community of formeteurs as a whole, by solving a variety of informational and incentive problems and reducing decision costs. Both the king and the council are likely to be selected by the formeteurs through some process of collective choice (direct or indirect elections) and some veto power over the government will normally be retained by the founders.

In the large number of formeteurs case, the use of divided forms of the king and council template also tends to reduce losses from selection errors, that is, from the failure to select the best persons to serve as managers and monitors under a particular existing reward system. In undivided governments, a single mistake in selecting an “organizational autocrat” can clearly be very costly. By dividing policymaking authority between a king and a council, this risk is reduced, because the policies adopted by such systems tend to be weighted averages of the institutionally induced interests of the “king” and “council.” The institutionally induced interests reflect the process through which these officials are selected and renewed, the reward systems in place, and the division of policy making authority between them. Consultation and compromise will be necessary for major decisions within such divided governments, which tends to reduce errors<sup>12</sup>

<sup>11</sup> Buchanan and Tullock (1962) use rational choice models to explore how particular governmental structures might be selected by such large groups. The focus of their analysis is political governments, rather than organizations in general, but many of their results are relevant for the present setting. For example, their results on voting rules are clearly relevant for the large group of formeteur setting. They do not mention the king and council template in their analysis, but they also suggest that divided governments (bicameralism) can be more likely to advance common interests better than undivided ones (unicameralism).

<sup>12</sup> In commercial enterprises, the formeteurs are often modeled as shareholders, who are assumed

Continued on next page...

The use of the “king and council” template also encourages error correction, because it increases the likelihood that more or less honest accounts of the organization’s activities are made available to the entire body of formeteurs. The founders may ask the council to report on the chief executive and the chief executive to report on the council on the occasions when they meet as a body. The natural inclination of the officeholders of each branch of government is to tout their own achievements and attribute all mistakes to the other. By combining the two reports, a reasonably complete overview can be achieved, albeit one with higher variance than would be ideal.<sup>13</sup>

Such informational and control advantages, reinforced by institutional conservatism, also explain why the king and council template is widely used to delegate authority within large organizations. A CEO may choose to create his or her own council of advisors. He or she may also delegate policymaking authority in particular policy areas to individual managers who are monitored and/or advised by committees of experts. The number of advisory councils can also be adjusted, and specialized advisory councils of various sizes can be created to analyze particular subjects or policy areas. The result tends to create hierarchical forms of organizational governance with “top levels” constraining the choices of “lower levels” through specific delegations of authority and control over selection and reward systems.

## **H. Overview: Formeteur Interests and Organizational Design**

This chapter has provided a theory of organizations that explain (a) why durable organizations have governments, (b) why most organizations use some form of the “king and council” template for governance, (c) why most organizations use mixed forms of conditional incentives to solve team production problems within the organization, and why (d) internal incentive systems and organizational policy tend to be somewhat flexible at the margin, although (e) core policies tend to be fundamentally stable and similar among organizations. An organization’s system of governance and its reward system tend to be stable, because organizations tend to make better decisions and be better able to retain and train their teams when they have “institutionalized” their reward and governance systems. The analysis also demonstrates (f) that decisionmaking authority within an

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to have a uniform interest. Within such large organizations, conditional contracts are also used to align the interests of CEOs with their formeteurs. See, for example, Gibbons and Murphy (1990) or Holmstrom and Milgrom (1994). That literature, while shedding a good deal of light on CEO compensation practices, tends to neglect divided governance within the firm and policymaking aspects of governmental decisions, although it acknowledges that contract “solutions” tend to be incomplete.

<sup>13</sup> Persson and Tabellini (1997), for example, demonstrate that divided government tend to increase information flows to principals.

organization can be distributed in a number of ways and argues that (g) the initial division of authority varies systematically with the origin of the organization.

As in other aspects of organizational design, formeteurs choose the institutions of governance. They do so based on their assessment of the performance of those institutions in other organizations about which they are familiar. The governmental templates that attract their interest tend to collect and use information relatively efficiently and to produce decisions that increase the viability of their organization, while advancing formeteur interests. This is not to say that the templates for creating organizational governments create completely robust organizations or advance formeteur interests perfectly, but it is to say that obviously ineffective and non-robust procedures for making policy decisions tend to disappear from the menu of governmental forms that attracts the attention of formeteurs.

Single formeteurs are inclined to adopt “king-dominated” forms of the king and council template of governance, partly for informational reasons. They will have standing councils of advisors, who make proposals for improving policy in areas of interest to the organization, which the formeteur will consider and choose whether to accept or reject. Formeteur partnerships, in contrast, will tend to adopt “council-dominated” forms of the king and council template in which day-to-day decisions are delegated to their CEO, but the authority to veto power major policy decision is retained by the partners. More evenly divided forms of the king and council template may be adopted in cases in which organizations are founded by a large number of formeteurs.

The analysis of the second half of chapter 2 suggests that informational advantages of the king and council template are sufficient to explain the use of this template for governance by a broad range of organizations throughout recorded history. Additional rationales for using the king and council template are developed in the chapters 3–5, in which long-term organizational viability and territorial governance are analyzed.



## **Chapter 3: Organizational Governance in the Long Run**

### **A. Governing in the Long Run**

All of the conclusions reached in chapter 2 about how formeteurs create organizations to advance short and medium term goals also apply to cases in which formeteurs attempt to advance long-run goals. Organizations created to advance long term goals have to overcome the same recruiting, motivational, and adaptation problems, which implies that they will have recruiting, reward, and governance systems that are fundamentally similar in most respects. Formeteurs that found organizations to advance long term goals confront similar problems and many of their solutions will also be similar. Formeteurs of such organizations, for example, are likely to be aware of the difficulties of robust organizational designs, so likely to pay even more attention to “best practices” when selecting governance and reward systems.

There are, nonetheless, significant differences between organizations designed to advance long term goals and those expected to be short lived. Perhaps the most obvious of these is that durable organizations will outlive their founders. In the long run, their formeteur(s) will necessarily turn over policymaking authority to successors of one kind or another. It is also likely that somewhat larger adjustments of the procedures of governance and other standing policies will be necessary in the long run than in the short run, because more unfamiliar (low probability and new) circumstances are more likely to be experienced in the long run than in the short run. Other members of an organization’s governing team (and their successors) will also need to be replaced.

Long run solutions to the problems of governance consequently include standing procedures for replacing their government officials, as well as procedures for adjusting the standing procedures of organizational governance. The latter, it turns out, are constrained by advantages of stable, predictable governance in the long run, as well as institutional conservatism. It turns out that the king and council template provides a variety of “natural” solutions for many long-term governance problems.

### **B. Decision Costs, Standing Policies, and Organizational Rule of Law**

Organizational governments face a continuing stream of decisions to be made. Should “we” continue what we are doing or change, and if the latter, how so? Because not every problem or opportunity can be analyzed simultaneously, a common decisionmaking procedure is to group

problems into more or less independent and separable subsets that can be dealt with one at a time. That is to say, organizational governments tend to use an “other things being equal” methodology analogous to that which is widely used in natural science, engineering, social science, and history. After such problem sets are identified, they can be ranked from most important to least important (from those most likely to those least likely to affect formateur interests significantly). This allows the time and attention of policymakers to be efficiently allocated among problem sets. Information is gathered and analyzed, as necessary, to rank both problems and alternative solutions for the problem class at hand. When this is done perfectly, the most important decisions are made first, the second most important second, and so forth.

If circumstances are stable and few mistakes have been made, past decisions will left in place. They will need to be revised only when new problems emerge or new relevant information becomes available. These policy decisions are normally enforced by the organization’s standing procedures for reward and punishment. Rule followers are rewarded and rule violators are normally punished (or not rewarded). In this manner, sequential decisionmaking by an organization’s governing body tends to create a more or less stable set of policies and rules for the organization. The result is a series of standing policies and rules that remain in force for significant periods: an organizational “law of the land.”

The stability of these standing procedures and policy decisions is increased by many of the same considerations that support rational institutional conservatism for internal reward systems. Forward-looking formateurs realize that predictability allows somewhat lower rewards to be paid to risk-averse team members through time and also tends to reduce intra-organizational conflict over decisionmaking procedures and responsibilities. Any hypothetical advantages from alternative rules remain abstract, untested, less studied, and so more risky. Moreover, changes in the standing rules will be resisted by those who had expected to profit from the existing routines, which increases the cost of changing the rules and further increases their stability.

### *Risk Aversion and the Economic Advantages of Stable Rules*

To illustrate the economic advantages of stable rules and patterns of enforcement, consider the effects of revising the organization’s artificial reward system. Suppose that the standing rules initially specify that if a team member performs duty D, he or she is entitled to reward R, but if not, he or she receives punishment Z. If the team member decides to leave the team, he or she receives payoff X. In chapter 2, following the rules was called “working” and disobeying the rules was called

“shirking,” which are plausible interpretations of choices to “follow” or “disobey” the rules that advance organizational (formateur) objectives. A ruleful-behavior inducing reward system has payoffs  $R > Z > X$ .

Instability and arbitrariness in rules, rewards, or punishments make the payoffs associated with following the rules stochastic, rather than certain. For example, suppose that, rather than certain reward  $R$ , there are two possible rewards for rule-following behavior,  $R_1$  and  $R_2$ , which are received with probability  $P_1$  and  $P_2$  when duty  $D$  is performed. Similarly, rather than punishments  $Z$ , there may be penalties  $Z_1$  and  $Z_2$  received with probabilities  $F_1$  and  $F_2$ . In such case, it is anticipated long term (average) rewards and punishments that matter rather than the specific rewards and punishments; here  $R^e = P_1R_1 + P_2R_2$  and  $Z^e = F_1Z_1 + F_2Z_2$ .

**Table 3.1**

**Inducing Rule-Following Behavior**

Team Member A		Team Member B		
		Obey	Disobey	Exit
Obey	$R^e, R^e$	$R^e, Z^e$	$R^e, X^e$	
Disobey	$Z^e, R^e$	$Z^e, Z^e$	$Z^e, X^e$	
Exit	$X^e, R^e$	$X^e, Z^e$	$X^e, X^e$	

The cell entries are the (expected) subjective payoffs for team members A and B for obeying or disobeying organizational rules and for leaving the organization.

Risk aversion implies that even if the same average payments are received by team members, the subjective value of those rewards and punishments is lower than that of the original completely predictable case. To further flesh out the illustration, suppose that the subjective value of reward  $R$  is  $U = R^{(0.5)}$ . Let  $R = 100$ ,  $R_1 = 50$ ,  $R_2 = 150$  and  $P_1 = P_2 = 0.5$ . The expected subjective value (utility) of certain reward  $R$  is  $(1.0)(100)^{(0.5)} = 10$ . The expected utility of the stochastic system of rewards is  $(0.5)(150)^{(0.5)} + (0.5)(50)^{(0.5)} = 9.66$ . The average reward for the stochastic system has to be more than five percent greater than the certain reward to generate the same subjective value.

When rewards are arbitrary or unpredictable, it will cost more to generate the subjective rewards that are greater than punishments and that are subjectively greater than rewards available outside the

organization. As rewards and punishments become less predictable, the net benefits of continued association with the organization becomes riskier, and less valuable for risk averse team members. In nasty environments, exit may not be an attractive option, but it is still a constraint on the arbitrariness of organizational incentive schemes. Even a pirate ship eventually arrives at port. In this manner, the economics of reward systems and exit possibilities reduce arbitrariness within voluntary organizations and also reduce the flexibility of reward systems.

Formeteur arbitrariness is thus constrained to the subset of “whims” that help solve team production problems or which have minor costs relative to the satisfaction obtained by the formeteur(s). Arbitrariness is acceptable to team members only if  $R^e > X^e$ , that is to say, only if the average reward for following the organization’s rules are greater than that associated with opportunities outside the organization.<sup>14</sup>

Risk aversion on the part of team members also implies that an organization’s government cannot costlessly adjust the organization’s rules to obtain modest short-term efficiency gains, because such adjustments tend to reduce rule-following behavior and increase recruiting and retention costs. The anticipated efficiency gains (or formeteur advantages) from reforms have to exceed the higher retention and recruiting costs associated with less predictable reward systems.<sup>15</sup>

### *Organizational Rule of Law*

As the standing rules becomes well-known throughout an organization, there will be an obvious distinction between day-to-day decisions made using standing procedures and revisions of the standing procedures and policies.<sup>16</sup> Insofar as the standing rules are generally believed to advance the interests of the organization, a widespread belief in the “rule of law” or “custom” as a norm might emerge among an organization’s government and among its membership. Such ideas will be

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<sup>14</sup> Advantages associated with manipulating exit costs are discussed in chapter 4 for the case of territorial governments. Exit cost–manipulating systems tend to increase retention at the same time that they increase the cost of recruiting new team members from outside the organization or territory of interest.

<sup>15</sup> In cases in which errors are made in detecting disobedience, the expected payoffs will have a similar probabilistic structure. In this case, there will be some probability that an obedient team member will be punished (receive  $Z$ ) rather than rewarded. And there will also be some probability that a disobedient team member will be rewarded (receive  $R$ ) rather than be punished. Monitoring also tends to reduce the cost of compensation systems. See chapter 4 below.

<sup>16</sup> Buchanan and Brennan (1985) argue that this is a key distinction between constitutional and nonconstitutional decisionmaking.

encouraged by the organization's leadership insofar as they increase organizational surplus or support their authority by, for example, reducing personnel costs or internal conflict.

Of course, organizational rule of law does not necessarily imply equality before the law in the sense used by modern legal scholars and liberal political theorists. Neither rewards nor punishments are likely to be uniform for all members of an organization. For example, senior members and relatives of the formeteurs may be subject to lower (or higher) standards of conduct and different punishments. Team members with greater exit costs or less attractive external opportunities may be paid less for the same work than those with lower exit costs and better external opportunities. Within large organizations there are also asymmetries in policy making authority. Policies made at "higher" levels of the organization bind others "below" them. In this manner, asymmetries in authority creates a hierarchy in which one's "level" is determined by one's relative ability to impose rules on others in the organization. This is not to say that all rules are developed "top down," but it is to say that those at lower levels have less influence over policy than those at upper levels, essentially by definition.

Such unequal and asymmetric reward and punishment systems can, none the less, be systematic and rule based. They may be stable for long periods of time, because they advance the interests of "law-abiding" team members and forward-looking organizational governments.<sup>17</sup>

A subset of a prominent organization's standing rules may also be incorporated into a community's civil law in places in which such rules are widely believed to increase efficiency, equity, stability, or justice. There are, for example, many communities and regional governments that were originally founded by organizations such as firms, military organizations, and churches. Trading posts, military bases, and monasteries often catalyze the formation of towns and cities. Colonial enterprises often create regional and local governments in order to advance their economic, military, and religious agendas.

### **C. Constitutional Organizational Governance: Written and Unwritten Charters**

Standing decisionmaking procedures and norms do not have to be written down to characterize an organization's government or reward systems, although this is often done in large organizations to increase predictability and reduce conflict. Written rules increase certainty for those subject to their rewards and punishment systems and reduce conflict by reducing the scope for disagreement about what the standing procedures really are. Formeteurs adopt written rules not because they

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operate behind a veil of ignorance or necessarily believe in the “rule of law” as an abstract principle of justice, but for the practical reason that stable well-understood procedures tend to improve the performance of their organizations and reduce their costs, just as written contracts that specify the terms and duties of agreements between independent persons and organizations tend to increase the value generated by such agreements. Without such standing rules and systematic rewards and penalties, the cost of team production would be higher, and organizations would lose productive team members to other organizations in which rewards and punishment are more predictable. Even pirate captains often use written contracts to attract and keep an effective crew on their ships (Rediker 1989, Anderson and Gifford 1996, and Konstam 1998, Leeson 2007).

A written charter for an organization can be regarded as its “constitution” insofar as it describes the core procedures for making standing policy decisions, the selection process for membership of its decisionmaking bodies, and describes how authority to make and revise policies is distributed. It bears noting that such core procedures and constraints are normally far easier to describe than are the many informal relationships that completely determine an organization’s decisionmaking procedures. In cases in which such informal practices are also durable, stable, and significantly affect policymaking decisions, it may be said that large organizations have both written and unwritten constitutional rules. The fact that a written description is incomplete, however, does not imply that written rules have no effect on an organization’s practices. It only implies that the *de facto* standing decision procedures and compensations systems are more complex than represented in writing.

Although there is a sense in which an organization is only as old as its charter, there is also a sense in which every charter tends to be far older than the organization described. Both the written and unwritten parts of an organization’s charter normally include procedures and norms taken from organizational templates that proved successful in earlier times.<sup>18</sup>

#### **D. After the Founders: the Problem of Succession**

At some point in time, every durable organization has to move beyond the period in which formateurs dominates their organizational governments. In some cases, this may occur because the

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<sup>18</sup> See, for example, Sterzel (1994) for a concise overview of the historical antecedents of contemporary administrative law and procedures in Sweden. Evidence of the importance of innovations in writing and record keeping is developed in Dudley (1991, 2000), who provides a historical and economic analysis of how informational technologies can affect the size and scope of territorial governments. Although his analysis focuses on bureaucratic reforms within territorial governments, his analysis of the importance of information technology clearly applies to other organizational bureaucracies as well.

formeteurs decide to transfer all of their authority for making policy decisions to others, so other matters can be focused on, perhaps founding other new organizations. In other cases, formeteurs may retain control until they become incapacitated because of illness, age, or death. Formeteurs do not live forever. In both cases, the transition from formeteur to successor governments is often a crisis point for organizations, because effective governance often ends with a formeteur's departure. The formal rules were developed with the formeteur goals and talents in mind and the supporting culture of the enterprise may have largely been based upon deference to the founder(s). The departure of the formeteur(s) thus tends to undermine both the governance and culture of their organization.

### *Solutions to Intra-Organizational Conflict Can Increase Succession Problems*

Although durable organizations outlive their founders, it bears noting that durability in this sense is not always in the formeteur's interest. A formeteur often becomes wealthy or widely respected as a consequence of his or her organization's success. Successfully solving team production and governance problems often produces profits, prestige, and power.

To the extent that these are largely consequences of successful standing procedures, others inside and outside the organization may attempt to obtain those rewards for themselves by taking over the organization's government. The greater the rewards available to the organizational leaders the more it pays to seek such high positions. Competition over who will rule an organization can be intense, but such internal competition is not always good for the organization, because it diverts the time and attention of formeteur(s) and potential rivals away from solving organizational problems. By doing so, it tends to reduce and/or consume a substantial part of the organization's potential surplus. Moreover, those engineering successful takeovers (and palace coups) normally replace the organization's top officeholders (those with the most policymaking authority), which usually includes the formeteur(s), as noted in chapter 2.

Formeteurs naturally take the risk of being pushed aside and losses from internal rent-seeking into account when choosing their organizational designs. One organizational strategy used by many formeteurs is to make themselves "irreplaceable." Opportunities for rivals to secure the experience and broad support necessary to become an organizational rulemaker may be blocked in various ways. Potential rivals may be rotated among distant posts or banished from the organization when serious threats are detected. The responsibilities of other senior team members may be narrowed

and routinized beyond the point of economic efficiency to make them easier to replace and also less able to replace the formeteur.

This method of maintaining control and reducing internal conflict makes the formeteur's policymaking experience unique within their organization and critical for their organization's continued success. In such cases, it will be widely understood by team members that replacement of the "ruler" would tend to reduce the effectiveness of organizational decisionmaking. This further reduces support for possible rivals and increases opposition to such takeovers. It also reduces the "leadership rents" available to potential rivals. In this manner, organizational designs that create "irreplaceable" rulers tends reduce unproductive conflict within the organization and increase the expected returns of those holding leadership posts.<sup>19</sup>

Unfortunately, while advancing formeteur interests, that particular solution also implies that a formeteur's departure or death tends to greatly reduce the efficiency of his or her organization. The death or exit of a founder in such cases tends to create an organizational crisis. It reduces the effectiveness of organizational governance and produces new conflict for control of their organization among possible successors. These effects reduce the organization's ability to respond to new circumstances, reduce its surplus, and may also undermine the organization's internal culture by reducing cooperation among other team members.<sup>20</sup> It is for such reasons that many clubs, family businesses, small churches, and dictatorships often disintegrate shortly after their founder's death or departure.

In contrast to many other governance problems, the irreplaceable formeteur does not have strong reasons to solve the resulting transition problems, although other members of the organization (and his or her heirs) may. Whether such formeteurs have interests that extend beyond their departure or death depends partly on their goals, partly on the nature of their organization's enterprise, and partly on the institutions in place.

### *Organizational Leadership Posts as Property*

The simplest solution to the succession problem confronted by an irreplaceable formeteur is to simply appoint a successor shortly before his or her departure. Leaving the decision to the last

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<sup>19</sup> See Tullock (1987, Ch.2) for an overview of some of these strategies. See Hillman and Katz (1987) for a model of internal conflict over organizational rents.

<sup>20</sup> The modern contest and rent-seeking literatures demonstrate that conflict in such circumstances will often consume the entire surplus of the organization (Tullock 1967). See Buchanan, Tullock, and Tollison (1980) or Congleton, Hillman, and Konrad (2008) for rational choice research on how institutions can encourage or reduce unproductive conflict within a wide variety of settings.



moment reduces the risk of overthrow by a rival whose talents have been acknowledged by the organization's leadership. A similar appointment procedure can be used to replace loyal, productive members of a council as they depart. Although there are advantages to making such decisions at the last moment, there are also advantages for announcing the procedures through which these decisions will be made before the decision is to be made.

In such cases, persons who wish to be chosen will attempt to attract the formeteur's attention and favor. The rules of this succession game can be adjusted to assure that the formeteurs receive good service and advice from a broad cross-section of talented persons within the organization. Well-designed contests may also increase the organization's effectiveness.

Under such procedures, the top leadership post of the organization effectively becomes the "property" of the formeteur provides formeteurs with several reasons to adopt such procedures. . When the most productive supporter of the formeteur is appointed, the successor may be said to have bought the post in an "all pay" auction among insiders. When the post of "king" can literally be sold to the highest bidder—as true of many commercial enterprises—leadership positions can be auctioned off to insiders and outsiders. Both types of auctions create incentives for otherwise self-centered formeteurs to create effective durable organizations that address succession issues, because both internal and external auctions allow the formeteur to profit today from the future effectiveness of the organization after he or she is gone.

Unfortunately, as noted above, it is not always possible to design contests for top positions that limit the efforts of contestants to productive activities that benefit the formeteur(s). In practice, rivals often compete with each other in a manner that reduces the effectiveness of the organization, as with attempts to destroy the reputations of rivals by spreading falsehoods, or to destroy the rivals themselves. Nor is it always the case that the formeteur's departure can be fully anticipated.

Robust procedures for replacing organizational leaders must account for surprise departures, for the possibility that unproductive competition for the leadership posts takes place, and for the leadership's interest in avoiding overthrows.

## **E. Succession within King and Council Systems of Governance**

Within the king and council systems of governance, another method of addressing CEO succession problems is possible. Namely, the council may be authorized to appoint successors. Knowledgeable persons from inside the organization may be able to judge the skills necessary for effective organizational governance, which may differ from those necessary to launch a palace coup.

The entire council is unlikely to die or depart suddenly. The use of councils for such decisions also tends to reduce unproductive conflict when council members make decisions through majority rule (Congleton 1984). Replacement members of the council may be chosen by departing council members, the remaining council members, the “king,” or jointly determined.

In this manner, the king and council template allows an organization’s government to be gradually renewed by those with the largest stakes in continuation of the organization and the most intimate knowledge of its operation.

Such arrangements have been common historically within a broad cross-section of organizations, including churches, commercial enterprises, and national governments. A council of cardinals selects the new pope, and the pope selects new cardinals. A board of directors hires a new CEO and the CEO appoints (or nominates) new board members. A parliament or council of electors directly elects a king or indirectly determines them by specifying rules for succession. Kings often had the authority to appoint (or nominate) new council members, as with elevations to the noble chambers of parliament.<sup>21</sup>

### *Inheriting the “Throne”*

In cases in which an organization’s council cannot agree on a new CEO, because of problems associated with internal factions that produce majority cycles, conflict among council members can also consume substantial resources (including in some cases assassination of rival council members). Such occasions of council indecision and conflict tend to reduce their organization’s prospects for survival insofar as governance or continuity is important during the period of interest. In such cases, a more or less automatic method of selecting successors may prove superior to council deliberations.

A very common mechanistic solution to the transition problem is to make the formeteur’s oldest son his successor. By avoiding organization-threatening conflict at times of transition, such dynastic organizations have more resources available to weather the storms that confront every long-standing organization. It also reinforces incentives for formeteurs (and their successors) to consider the long-term consequences of their decisions carefully, insofar as parents value the future prospects of their first-born sons and daughters.<sup>22</sup> Perhaps surprisingly, several cases exist in which a council representing noble interests voted to make the office of king hereditary, as, for example, was

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<sup>21</sup> The British King’s ability to appoint new members to the House of Lords, perhaps surprisingly, played an important role in early suffrage reform, as noted below in chapter 13.

<sup>22</sup> See Buchanan (1983) for an analysis of disputes for inherited wealth and position. Usher (1989) and Tullock (2002) analyze dynastic governance in the context of nation-states.

true in Sweden in 1544. The “right” of inheritance is another sense in which a formeteur may be said to own his or her organization.

It bears noting that in most cases successors “chosen” in this manner tend to be less talented than the organization’s founders. Genetics suggests reversion toward the mean. However, successors can often be less talented than the organization’s founders without significantly reducing the effectiveness of the organization, because relatively efficient governance and internal reward systems are already in place. Moreover, access to education and the formeteur’s advisory council implies that the policy decisions reached by the formeteur’s heirs will be nearly as well informed, if not always as well judged, as those of the formeteur.

It also bears noting that this form of secession has effects on the balance of authority within the king and council system. A less talented successor CEO tends to become (and should become) more dependent on his or her council of advisors. This dependence simultaneously increases the relative policymaking authority of the council and frees the heir to devote his or her time to activities that are of greater interest than managing his or her parent’s organization. The new balance of authority tends to increase the long-term viability of the organization by improving governance.

That positions in organizational governments are often inheritable suggests that avoiding unproductive intra-organizational conflict over leadership posts is often more important than maximizing the talent of the persons with rule-making authority.

## **F. Organizational Interests: the Institutional Conservatism of Successors**

As noted above, formeteurs normally decide which forms of team production will be engaged in, which reward systems will be adopted, and the standing procedures for making organizational decisions. In the case of durable organizations, they will also choose procedures through which the offices of the organization’s government are renewed through time. The members of an organization’s successor governments thus tend to be selected by standing procedures and receive rewards from a stable system of pecuniary and nonpecuniary rewards. An organization’s officeholders have standing tasks and duties within their organizations that are supported by their organization’s reward and recruiting systems. These systems provide officeholders provide incentives for the successors to make decisions that tend to increase the effectiveness of the organization’s team production.

Although every member of an organization’s government has his or her own personal constellation of private interests, all members of the organization, including its governmental office

holders, have “induced interests” that are generated by the durable rules that characterize the organizations of which they are members. In this sense at least, a durable organization—or at least its government—may be said to have “its own” interests as implied by the systematic effects of its standing reward and selection systems on both team members and organizational leadership. Social scientists take account of such induced interests when they characterize senior managers of commercial enterprises as “profit maximizers,” democratic politicians as “voter maximizers,” and persons in the mass media as “publicity hounds” or “fame maximizers.”

Insofar as those procedures continue to advance the interests of top officeholders after the formeteurs depart, successors have interests similar to those of the founders. They will support the standing procedures of their organizations, because they facilitates their ability to make policy, solve team production problems, and reduces internal conflict. In cases in which successors believe that they could not have created an equally productive organization by themselves, they will tend to be even more defensive of existing organizational routines than formeteurs. Successors also tend to be loyal *organizational men and women*, because standing organizational reward and selection systems have long played an important role in their personal life plans.<sup>23</sup> In most cases, it is through their organization’s standing procedures for reward and renewal that successors rose to leadership positions and so “earned” their income, policymaking authority, and status. Institutional conservatism, in this case also can be employed to justify their relatively high income and prestige.

Moreover, durability itself may become an asset for recruiting and motivating team members insofar as it suggests that team members may count on their promised rewards. Durability may be demonstrated to team members with stories, pictures, or statues of past organizational leaders and past organizational successes. Remembering and honoring the past tends to important for the senior members of durable organizations for a variety of practical reasons.

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<sup>23</sup> This characterization of organizational men and women differs from Whyte’s (1956), but bears more than a passing resemblance. As in Whyte, it argues that the personal goals of individuals do not have to change for loyalty to the organization to develop. Rather, it is induced by the organization’s incentive system and its success through time. In the present case, however, “organizational interests” are not limited to middle managers. Indeed, it may apply more to senior managers, who are often most tied to their specific organization’s aims and survival, because of specialization and their organization-specific knowledge of internal procedures and personalities.

## **G. Amending the Organizational Charter**

To argue that stability has advantages for formeteurs and their successors is not to say that a durable organization's practices are completely rigid. First, as noted above, all durable organizations have standing procedures that allow them to identify and respond to changing circumstances in a manner that advances organizational goals. That is to say, they have governments. A completely "rule-bound" organization does not simply repeat today what it was doing yesterday; it uses standing procedures to respond appropriately to new developments. Second, the standing procedures for making policy decisions are subject to modification. When other procedures have been demonstrated to work better than current ones or current ones fail, an effective organization will adopt new rules, because they better advance formeteur and successor interests. Improved organizational governance increases productivity and reduces decision errors, which allow larger and more consistent rewards to be provided to team members through time. However, institutional conservatism implies that such modifications will be infrequent and tend to be modest in scale and scope.

The possibility of amendment is partly a consequence of succession. Each new generation of organizational leaders will have some ability to adjust organizational procedures in ways that benefit themselves. In many cases, this will be done through informal bargains reached among the officeholders in a manner analogous to that developed below in chapters 5 and 6. Formeteurs, however, also have interests in choosing organizational designs that are somewhat flexible insofar as they are able to profit from the future performance of their organization.

Forward looking formeteurs acknowledge that their organizational designs are not perfect, that it is not the best possible design for all possible circumstances. As consequence, they will include formal and informal procedures for amending their organizational charters and tend to adopt institutional templates that allow such changes to be made without requiring their organizations to be reinvented every time a change in governance seems advantageous. Such forward-looking organizational charters increase the value of organizational leadership posts for their successors and allows them to extract part of that value through productive forms of intra-organizational competition associated with those seeking those positions of authority.

Forward-looking formeteurs will thus characterize amendment procedures for the procedures of organizational decisionmaking and will tend to adopt governance systems that lend themselves to

adjustments at many margins. The former allows reforms to be adopted as necessary, the latter allows them to be adjusted without reinventing the organization as a whole.

The king and council template allows both amendment procedures that are more restrictive than the procedures of day-to-day governance and includes a variety of margins for adjusting policymaking procedures. Amendments, for example, might require the assent of both the king and the council, whereas day-to-day policy decision may only require decisions by the king. The procedures of governance within that king and council can be adjusted to increase or decrease the scope of the king or council's authority to make decisions, and by changing the manner in which decisionmaking authority is shared in areas in which both the king and council exercise control. The balance of authority between the king and council, for example, might need to be adjusted to account for advantages of deliberation or speed when making policy decisions during times of crisis or to reflect changes in the talent and ambition of council members and kings. The procedures through which kings and councils are selected may also advance organizational interests if the goals of the organization change or if the pool of potential government officeholders changes through time.

The king and council template can also be used to alter the distribution of policymaking authority within an organization as it changes in size. The king and council template is scalable in the sense that it can easily be adjusted for use in large and small organizations. It is also nestable which allows hierarchical systems of policymaking authority to be developed by delegating subsets of policy making authority to "lower levels" of kings and councils. Regional offices and other subdivisions of a large organization may have their own CEOs and councils that make a variety of local policy decisions. A local government may be formed with its own governor and provincial assembly. The latter allows hierarchical governance structures to emerge, based on the king and council template, as the organization expands in size or scope.

### *A Digression on Contemporary Amendment Procedures*

Consistent with that prediction is the fact that the standing procedures for amending organizational charters and governmental constitutions tend to be substantially more difficult than procedures for changing day-to-day policies. For example, contemporary amendment procedures within democratic states normally require a broader consensus and longer process of review than is required to make day-to-day decisions. Article 5 of the U. S. Constitution requires amendments to be approved by a two-thirds majority of both chambers of the legislature and then approval by

three-fourths of the state legislatures. Ordinary legislation requires only majority approval in both chambers of the legislature and acceptance by the president, state governments are not consulted. Article 15 of the Swedish constitution requires amendments to be approved by two successive parliaments separated by an election. Ordinary laws require approval by only a single parliament.<sup>24</sup>

Similarly, revisions to the charters of contemporary private organizations are normally constrained by civil law, as well as provisions of the charters themselves. In most cases, external approval is also necessary. For example, section 11 of the charter of the American National Red Cross gives the U. S. Congress the sole power to amend its charter, although they may, of course, do so at the request of the Red Cross. The core policymaking procedures of international organizations, such as the European Union and many other treaty organizations, often require the unanimous agreement of treaty signatories.

### *The Advantages of Predictability Limits the Scope for Constitutional Reform*

To say that some institutional flexibility helps organizations survive in the long run, however, is not to say that organizational designs are completely flexible. Given the advantages of institutional conservatism outlined above, the procedures for changing organizational charters tend to be more time consuming and demanding than those required for making day-to-day decisions. To serve as “rules of the game,” an organization’s decisionmaking procedures and informal norms have to be reasonably stable in the short and medium term. The benefits of predictable standing policies would be lost, if an organization’s procedures for choosing policies became totally unpredictable. Consequently, even formateurs who retain complete control over their organizations have good

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<sup>24</sup> The constitution law of the United Kingdom is nearly unique in not specifying an amendment process that is more complex than that of ordinary legislation. The constitution of the U. K. consists of a series of laws with special status rather than a single document. Generally speaking, majority approval in the House of Commons is, thus, sufficient for both new constitutional provisions and new legislation. The latter makes it difficult to discern clearly the difference between constitutional and ordinary legislation. Yet, as argued below in section C, the latter is not uniquely a problem for the United Kingdom. Most political constitutions include core procedures and constraints that are enacted as ordinary legislation.

A modern curiosity for constitutional theorists is the current Swiss constitution. It includes many checks and balances on both ordinary legislation and constitutional revision, and specifies a *less restrictive* petition to force *ordinary legislation* to be passed by referendum (50,000 signatures; see Article 89) than to force a proposed constitutional revision to be subjected to direct referendum (100,000 signatures, see article 120). A smaller minority can demand a referendum on ordinary legislation than for constitutional referenda. This implies that a greater supermajority is required for adopting ordinary legislation, without a referenda, than for adopting constitutional amendments.

reasons to use their power of amendment infrequently. Constitutional self-restraint reduces uncertainty for team members, suppliers, and customers.

The advantages of predictable procedures together with the uncertainties associated with major reform proposals imply that proposed rule changes tend to be piecemeal, rather than whole cloth, and tend to be infrequently adopted in stable political and economic environments. Most charter amendments will address a particular class of problems and take for granted that most other standing rules will remain in force. For example, a business may increase the size or change the voting rules within its board of directors without changing the rules for electing directors or the relationship between the board and chief executive officer. A church may change its procedure for appointing ministers or priests without changing other management practices, religious doctrines, or the location and times of church services. A territorial government may change its suffrage rules or electoral procedures without changing other aspects of governance such as the number of chambers in parliament, the relationship between the executive and parliament, or the organization of the bureaucracy.

In this, the usual process of governmental reform tends to be similar to that of “normal” science. The “*ceteris paribus*” methodology of normal science allows progress to be made one step at a time as theories are refined in fields and subfields of study. Even reforms and “breakthroughs” that seem “radical” when adopted usually appear relatively modest with the benefit of history’s hindsight. Most theories in other subfields and fields remain unaffected by such breakthroughs. In the organizational context, the relative merits of governmental reforms (and their effects) also tend to be easier to imagine and analyze than are great shifts in organizational templates. An automobile company is more likely to change the models produced and methods of production than to suddenly reinvent itself by taking up spaceship design or deep sea mining.

## **H. Conclusions: Some Common Properties of Durable Organizations**

The analysis of chapters 2 and 3 suggests that there are a mind-numbing number of design parameters to consider simultaneously, when founding an organization. There are infinite varieties of reward systems, recruiting systems, and governance systems that can be imagined, and each combination of these systems tends to have different advantages and risks associated with them, which vary according to the goals to be advanced and the environments in which the organization will operate. If formateurs knew the properties of every constellation of decisionmaking procedures and internal incentive systems and could perfectly predict the future, they would pick the one that



most perfectly advanced their goals, that is, the most efficient organizational design. If, however, the range of alternatives is not entirely known and even what is known cannot be fully analyzed at reasonable cost, formateurs will realize that they can make a variety of mistakes when forming organizations and recruiting teams. In such cases, prudent formateurs will choose their governance, recruiting, and reward systems for the most part from existing organizational templates known to function relatively well, and perhaps adjust them a bit at the margin for the purposes at hand. Knowledge and calculation constraints rule out perfect solutions by formateurs.

This assessment of the problem of institutional design differs from the mathematical solutions characterized in the mechanism design literature in several ways. First, it acknowledges the limited scope of the knowledge of formateurs and also their limited time for appraising the alternatives they do know about. Second, the best institutional designs in the mechanism design literature are often of the “ridge line” variety that require net benefits to be maximized at every instant, as for example, in Holmstrom and Milgrom (1994). In such cases, myopic and long term analyses reach essentially similar conclusions about the best standing policies. Such solutions, however, characterize intertemporal optimization problems only under fairly restrictive mathematical assumptions; for example, when the objectives are concave, differentiable, and continuous and the constraints are convex and continuous.

In the real world, one cannot always climb to the top of a mountain range by simply striking out for the closest ridge and following it upward, because not every ridge leads to the top. The jaggedness of mountains is a problem for both partially and fully informed theories of mountain climbing and trail design. In the real world, most trails that climb mountains head upward for the most part, but they do not usually follow ridge lines or rise at every point.

The properties of alternative institutional designs also tend to be a bit ragged (non concave) and discontinuous. Nonetheless, much of what has been argued about reward and recruiting systems in Chapters 2 and 3 is compatible with the microeconomics literature on organizational incentive systems and mechanism design. The types of “mechanisms” that continue to attract the interests of formateurs and their successors will tend to solve the various internal incentive and recruiting problems analyzed in those literatures. Similarly the analysis of organizational governance developed is compatible with most contractarian theories of the state and most analyses of institutionally induced equilibria in governing organizations. In cases in which formateurs create an organizational government to which significant policy making authority will be delegated, the institutions of governance will tend to reflect considerations similar to those analyzed, for example, by Buchanan

and Tullock (1962). And it is possible that the profits of the organization will be distributed among formeteurs in a manner analogous to those described by Rawls (1971). Inequality among formeteurs may be tolerated only insofar as it increases organizational efficiency.

The processes through which those solutions tend to be developed and adopted, however, differ from those characterized in these literatures, however, in that organizational designs reflect a long series of modest experiments by formeteurs and their successors through time, rather than a single optimizing choice by a well-informed forward looking entrepreneur or constitutional convention.<sup>25</sup> Instead, the designs and experience of previous generations of formeteurs are assessed by persons contemplating the formation of new organizations. The organizational designs most chosen by successive generations of formeteurs provide a menu of organizational designs that will be particular interest to contemporary formeteurs, because they are known to have advanced formeteur interests in a wide range of circumstances in the past.

Knowledge problems and jaggedness do not imply that reaching the highest point in a mountain range is impossible or that hikers are necessarily walking on sub-optimal trails. Rather it implies that identifying the “top” and finding the best trails to the top will be the result of trial and error by a long series of mountain climbers who learn from one another’s innovations and mistakes. Although the best trail known at a point in time may not be the best that will ever be found, such trails may be used for centuries with only minor variations, as true of organizational designs. Similarly, the best trail will vary somewhat with the technology of transport and goals of those using them. The best foot trails, horse trails, and automobile trails share many properties but are rarely identical.

This is not to say that organizations are entirely products of history or technology. Each part of each organizational design on the “menu of best practices” is the result of past experiments and assessments by formeteurs about what “works.” In most cases, previous reforms of preexisting templates were undertaken with specific performance improvements in mind, and in cases in which the hypothesized improvements were realized, the reforms were not only kept but copied by other formeteurs and their successors. The historical requirements for survivorship of organizational templates are also affected by the decisions of formeteurs. Only those organizational designs that have advanced formeteur interests well enough to be copied by other formeteurs will be widely known or considered by them. Organizational experiments that failed to advance formeteur (and

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<sup>25</sup> See, for example, Williamson (2002) or Spulber (2008) for overviews of this extensive literature.

successor) interests tend to disappear from the menu of organizational designs—although they may continue in “managerial mythology” as instances of designs and policies to be avoided.

### *Some Common Features of Robust Organizational Governance*

The common interests and problems of formeteurs imply that the menu of best practices for organizational governance share a number of properties, a subset of which have been identified in chapters 2 and 3. First, every durable organization will have a body of internal procedures for making policy decisions that serve as its charter or constitution for governance. The standing rules normally specify: the officeholders who participate in major decisions and the manner in which those officials interact to make decisions. The latter may include specific architectures for policymaking that group and/or assign tasks to subsets of officeholders. The standing procedures of long-lived organizations also include rules governing the selection and succession of officeholders, and standing procedures for modifying the organization’s charter.

Second, although the existence of an organizational government allows organizations to potentially change policies every instant and the existence of amendment procedures potentially allows organizations to reinvent their procedures of governance every day, durable organizations will not do so. Institutional conservatism is supported by the risk aversion of government officeholders and team members, as well as various economic advantages associated with being “conventional.” Durable organizations tend to have standing policies for recruiting and rewarding team members, because it is in the interests of most organizational governments to have predictable policies on these matters. The core procedures for making organizational policy decisions also tend to be stable, partly because of similar advantages associated with predictable policies, and partly because governance stability reduces unproductive internal conflict. Reward and governance systems are only adjusted in circumstances in which the benefits are expected to exceed the cost of lost predictability. The reforms adopted tend to be “piece-wise,” focused at solving particular problems rather than reinventing the organization. Such modest reforms preserve advantages associated with existing procedures and to avoid unforeseen costs generated by large institutional experiments. Although many such changes may be proposed and evaluated, only a few will be adopted.

Third, the founding charters and constitutions of organizations favor formeteur interests, because formeteurs normally draft their organization’s founding documents. For example, the number of formeteurs that found an organization affect the initial division of authority within the organization’s government. The standing procedures for governance are not be developed anew for

each new organization, but are substantially copied from successful organizations of the past. In many cases, the standing procedures are written down in formal charters, compacts, or other similar documents to reduce uncertainty. Formateur opportunities to profit from their organization, however, are constrained by the tasks undertaken and the environment in which their organization's operate. These limit the extent and kind of "leadership rents" that can be extracted from their organizations.

Fourth, the analysis predicts that successor governments tend to be more conservative than formateur governments, because subsequent leadership is more dependent on preexisting institutions for their positions of authority. Increased rational conservatism, however, does not imply that durable organizations exhibit complete institutional rigidity, but it does imply that experiments will tend to be relatively small and that strictly "organizational interests" tend to emerge on the part of an organization's leadership. Durable organizations will exhibit considerable continuity in their procedures of governance and amendment.

Fifth, the analysis demonstrates that the "king and council template" for governance can be used to address a variety of long term governance problems. The king and council template provides several robust solutions for succession problems and also allows authority to be shifted between the king and council in a manner that can improve organizational decision making. King-and-council based governments thus can be "finely tuned" to take advantage of new circumstances and the talent and skills of successors and formateurs without changing the fundamental architecture of the organization's government. These advantages, in addition to the informational advantages discussed in chapter 2, suggest that it will often be prudent for formateurs (and their successors) to adopt forms of organizational government based on that template.

Of particular importance for the main purposes of this book are the subset of durable organizations that are or become territorial governments. When the above analysis is applied to territorial governance, it implies that governance will tend to be rule bound, but flexible, and that policymaking authority is likely to be shared in practice, rather than vested in a single person or committee. This contrasts with most pure models of dictatorship and democracy analyzed by most political scientists and political economists. It also challenges the practical relevance of political theories that rely on or defend undivided sovereignty, such as Hobbes' (1651) theory of social contracts. The reforms of territorial governance of greatest interest for this volume are those that can account for the peaceful emergence of parliamentary democracy from organizations that are initially based on relatively autocratic forms of the king and council template.

## **Chapter 4: The Origins of Territorial Governance**

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 devise and enforce rules for their team members to solve team production problems and to direct an organization's resources to advance specific purposes. The other meaning of the term refers to the subset of organizations that have extensive ability to impose rules on persons within a particular geographical territory. Chapter 4 provide an explanation for how the former can become the latter

All organizations can impose rules on their own team members, because realizing the fruits of team production normally requires team members to perform certain tasks at particular times with particular persons in a particular manner. The range of behaviors that can be induced by organizations varies substantially, but many organizations exercise significant control over their members. An organization's management is often able to tell team members how to dress, when and what to eat, and when and how to work, and even who their friends should be (other team members). The organization's management may induce team members to go on trips far away from families and friends (as with hunting clubs, commercial transport shipping, and military operations), via means and to settings that involve risks to life and limb. They may induce persons to sacrifice the necessities of life for a period—fasting and abstinence, for example, are often required for the members in religious organizations.

Many organizations can also impose rules on “outsiders.” Both suppliers and customers may have to accept some rules in order to sell their products to an organization or purchase an organization's output. “Deliveries at the back,” “Sales of our products take place only on Saturday from 10:00–14:00.” Territorial governments are the rule-making, policymaking bodies of organizations that have relatively great ability to impose rules on outsiders within a geographic territory.

This chapter provides a theory of the emergence of territorial governments as one of many productive organizations in an initially peaceful territory. The analysis draws from and extends the productive theories of the state found in the work of Aristotle (350 BCE), Montesquieu (1748), Nozick (1974), and Buchanan (1975). The general approach differ from other theories of the state by stressing the advantages of collective action, rather than coercive aspects of governance. The

analysis of this chapter focuses on the incentives of formeteurs in such settings and the gradual emergence of governments, rather than a sudden shift from anarchy to statehood through conquest or social contract. It also notes that organizations with monopoly power over critical services in a region can impose rules on persons outside their organization. The ability of monopolists to do so, however, is constrained by the mobility of the persons “ruled.”

### *Problems with Hobbes-Based Theories of Territorial Governance*

It seems clear that a Hobbesian (1651) war of “every man against every other” would not last very long in practice, because formeteurs would quickly organize teams for purposes of defense (and aggression), as noted by Montesquieu (1748). However, the Hobbesian low-income trap of “war of every man against every man,” does not literally require conflict among individuals. The same logic applies for “wars of every tribe against every tribe,” and “wars of every state against every state.” Peace treaties are notoriously difficult to negotiate and enforce, so wars among organizations can easily be all engrossing, perpetual, impoverishing affairs. The Hobbesian approach explains why persons and organizations tend to fight and why they would want to escape from an all-consuming conflict, but the solution proposed by Hobbes seems to require an all-powerful world ruler, or at least a continental, government, which we have never seen. The creation of military clubs cannot really explain how civil societies emerge in settings in which there is a good deal of natural conflict.<sup>26</sup>

It is likely to be the case that somewhat prosperous communities emerge before, rather than after, territorial governance and warfare. If there is nothing worth taking, why invest in theft or conquest?

Prosperous communities are far more likely to emerge, if conflict is initially limited, rather than all-encompassing, or if at least a few islands of relative tranquility exist. They may, for example, be initially protected by natural barriers of one kind or another. After prosperous communities emerge, their relative prosperity provides formeteurs in other places with incentives to organize theft and conquest. The existence of such organizations also provides prosperous communities with reasons to organize themselves against such attacks. In this manner, warfare is likely to be induced by the

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<sup>26</sup> See, Tullock (1972) for an early collection of rational choice-based analysis of the emergence of the state from anarchy. 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. See Congleton (1980) for an early discussion of how institutional reforms can reduce losses from conflict in Hobbesian settings.

relative success of early organizations, rather than their failures, but the resulting warfare cannot be all encompassing without eliminating the rationale for theft, conquest, and defense.

The nonviolent theory of the origins of territorial governance developed in this chapter does not imply that military organization and violent conflict are irrelevant. Rather, it implies that local prosperity does not require an initial escape from the Hobbesian jungle, nor does it require an initial monopoly of organized violence, as argued by many political theorists, including most recently Olson (2000) and North, Wallis, and Weingast (2009).

The approach and conclusions of this chapter are broadly consistent with the historical analyses of Spruyt (1994) and Ertman (1997), among others, who stress that nation-states emerged in the fifteenth, sixteenth, and seventeenth centuries as one of many organizational types through various coercive and non-coercive forms of competition. It is also consistent with Nozick's (1974) analysis of voluntary association within productive states, although no normative inferences are drawn from the present analysis. Territorial governments for the purposes of this book are simply organizations that have a relatively great ability to impose rules on persons outside their organization within a specific geographic area.

### **A. 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 sex. By analogy, it is often argued that in early human societies, a strong man simply uses 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 his extended family.

In less biologically-based groups, the physically strongest man may simply be a better forerunner than others, because he can solve many internal enforcement problems directly by threatening to punish 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 also 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, Hitler, and Mao were not unusually tall or strong men, although they ran powerful coercive organizations. Once durable organizations emerge, the "strong man" is simply the pivotal decisionmaker within his or her organization's government.

## **B. A Model of Coercive Rule of Communities where Exit Is Possible**

An organization's ability to impose rules on "insiders" and "outsiders" makes the boundary of an organization less than perfectly sharp, although that distinction is a useful one for the purposes of this chapter and as a description of relationships between territorial governments and their residents for much of recorded history. A commercial organization's "customers" are not "insiders," because they do not ordinarily participate in the firm's team production, although they clearly affect the viability of such organizations and indirectly affect their decisions. A religious organization's congregation participates in church services, but does not produce the sermons nor the doctrines being espoused. Similarly, community residents pay taxes and obtained benefits from their territorial governments, but rarely participate in decisions about taxes or the production of government services. The distinction between insiders and outsiders is less sharp in contemporary democracies grounded on popular sovereignty, but there is still a clear distinction between those who directly participate in government decisionmaking (elected representatives, the courts, and the bureaucracy) and ordinary citizens.<sup>27</sup>

Commercial, religious, and governing organizations can often impose rules on "outsiders," but only within limits. Those limits are not consequences of the size of an organization. Very large successful organizations are often created by energetic formeteurs, such as Henry Ford, Kiichiro Toyoda, Thomas Edison, Friedrich Krupp, Henry Dunant, Clara Barton, and the like. Such talented formeteurs can impose many rules on their team members, but relatively few rules on people outside their own organizations. Henry Ford once attempted to reduce his production costs by imposing a

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<sup>27</sup> The concepts of popular sovereignty and social contracts emerged during the seventeenth and eighteenth centuries. These theories, in effect, make the entire community the "true" formeteurs of governing organizations, whose authority is delegated to them by the residents. Although there are very few cases in which community governments were formed in this way, the ideas of popular sovereignty and social contracts can affect the willingness of subject-citizens to resist arbitrary rules and to lobby for constitutional reform as developed below.



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 purchased automobiles produced by his less demanding rivals, and Ford’s monopoly power quickly disappeared. The ability to impose rules on outsiders is limited by the exit opportunities of outsiders, rather than organizational size or wealth.

*Coercive Rule with Mobile Subjects*

The essential logic for requesting that outsiders follow particular rules, and for accepting such requests is represented in Table 4.1. It is sensible for an organization to make such requests of outsiders (that is, please follow rule D) as long as the organization’s surplus will be increased by the outsider’s compliance ( $\Pi - R > C > X$  or  $\Pi - R > X > C$ ). The outsider-resident expects to receive benefit  $R$  if he or she complies with the demand, expects to receive benefit  $B$  if he or she does not comply along with penalty  $P$ . He or she expects to receive  $A - E$  if he or she chooses to leave the community, where  $A$  is the expected net benefits from residence in the best alternative community and  $E$  is the member’s exit cost. The outsider-resident accepts the organization’s demand (obeys  $D$ ) only if the (long term) reward,  $R$ , from doing is greater than the alternatives of (long term) noncompliance and exit,  $R > B - P$  and  $R > A - E$ .

Table 4.1:  
**Payoffs for Formeteur-Ruler and Community Members**

	Formeteur	Resident
Community member accepts the organization’s demand.	$\Pi - R$	$R$
Community member(s) rejects the organization’s demand.	$C$	$B - P$
Former community member Emigrates.	$X$	$A - E$

In perfectly ruled polities, the productivity of the rules enforced is always greater than the cost of enforcement and the reward to community members is always sufficient to induce compliance. In such polities, community members always follow their government’s rules, because punishments are precisely targeted at community members that violate the rules. Residents remain in those communities, because the rewards are greater than those in alternatives communities, net of exit

costs. Such well-ordered communities are rare, however, because the information available to territorial governments is rarely sufficient for choosing only productive rules or for perfectly enforcing the rules chosen.

Nonetheless, the rules chosen and enforced have to advance organizational and community interests tolerably well, given the exit and cost constraints of territorial governments. Unless following community rules generates sufficient net benefits for residents, they will quietly depart for other communities with better governing organizations.

### *Exit Costs and Exit Control*

It bears noting that exit costs are not entirely determined by the natural physical and emotional costs of relocating, but are partly determined by the policies of governments.

Exit may be discouraged by encouraging the dissemination of information about hardships in other communities and about the dangers of travel to them. “You are lucky to be here, rather than there!” Information about hardships inside the community and about better alternatives may also be suppressed through censorship laws. Exit costs can be directly increased by punishing exit with fees of various kinds. Organizations 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. Exit may be illegal. There may be harsh punishments for even attempting to exit. Extreme examples of the latter include the fugitive slave laws common in all slave-holding societies, restrictions on peasant and serf mobility that were common in feudal Europe and Japan, and the Berlin Wall and “Iron Curtain” of the former Soviet Union.

Territorial governments that increase the cost of exit can reduce their rewards for compliance and/or increase their penalties for noncompliance without inducing mass exit by residents and team members, albeit at the risk of attracting fewer immigrants.

Exit costs are also partly a consequence of the “entrance costs” of other organizations and territorial governments. Because there are cases in which it pays to banish a person for shirking (as when  $X > C$  in table 4.1), it will be difficult for other organizations to judge whether a particular departure is a “voluntary exit” from a dysfunctional community or the “banishment” of a person for poor performance or criminal acts. Other organizations will not want to include shirkers or criminals from other communities on their teams, because they increase the cost of team production without producing sufficient offsetting benefits. Similarly, regional governments will hesitate to allow immigrants of questionable character to resettle in their communities. Rule-breakers increase

enforcement costs and reduce the productivity of territorial rules. Productive rule-followers would normally be welcome, insofar as they contribute to team or community output, but they may need to prove themselves before being accepted.<sup>28</sup>

In cases in which it is not easy to exit or join a given community, the calculus of remaining or becoming a resident will be based on the long-term average (expected) net benefits of affiliation relative to those available in other communities net of exit costs. Governments of communities whose residents have relatively high exit costs can use relatively severe penalties to enforce their rules, even if alternatives outside the community are somewhat better than those inside.

### *Predictable Rules and Penalties*

Whenever exit possibilities exist, there are limits to the feasible range of rules and punishments that can be imposed, as noted above. Exit possibilities also tend to encourage accuracy in the imposition of whatever punishments are used.

Organizations and communities that routinely impose penalties on the wrong persons have lower risk-adjusted net benefits for community members than otherwise similar organizations with smaller errors or less severe punishments. The expected reward of following a community's rules falls to  $[(1-p)(R) + (p)(B-P)]$ , when the probability of being wrongly punished, rather than rewarded, for following the rules, is  $p > 0$ . Persons in such communities would leave for other communities when punishments are relatively severe [ $(B-P)$  is below  $(A-E)$ ] and the probability of wrongful punishment,  $p$ , is relatively high.

This does not imply that arbitrary punishment is impossible, only that one community's error rate cannot be much greater than another's, net of exit costs, other things being equal. That is to say, punishment systems are constrained to fall within a band determined by exit costs and those used elsewhere.

A pirate ship captain can use more severe and arbitrary penalties—denial of food and water or accommodation on the ship itself—while at sea than at port. However, unless the bounty is unusually plentiful, a harshly sanctioned crew will depart for other ships as soon as a port is reached. Similarly, communities whose residents face unusually arbitrary and harsh treatment tend to

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<sup>28</sup> Communities with labor shortages and little fear of shirkers thus may attract new residents by eliminating entrance fees or rewarding people for joining their community with “citizenship” and other “signing bonuses.” During the medieval period, independent cities often rewarded serf immigrants with freedom from feudal duties after a period of residence. “City air makes one free” in such cases.

evaporate as residents (and team members) quietly depart for other locations where punishments are less arbitrary and harsh, unless the rewards from continued association are also unusually great. The anticipated net rewards of continued association have to be kept above those of the available alternatives.<sup>29</sup>

### *Inequality Before the Law*

To say that community governments are constrained in their ability to use arbitrary and harsh punishment is not to say that the rules enforced will be the same for all community members or that the rules will be enforced in a uniform manner.

In many cases, a community's residents are heterogeneous in ways that affect a government's return from rules and enforcement. Some residents and some team members provide services that are more important for their communities and organizations than others. Some residents have better exit opportunities than others. The minimum acceptable combination of rewards, punishments, and punishment errors varies among community members, as does the extent to which governments profit through their association with particular residents. In such cases, organizations will treat different residents or classes of residents differently, because they cannot afford to over pay for compliance, nor can they afford to provide rewards below those required for retention.

As a consequence, unusually productive community members who could easily move to other communities will be more carefully treated (subject to less arbitrary punishment) and receive higher rewards for their efforts (or subject to lower taxes). A wealthy merchant may be subject to different rules and penalties than a wealthy farmer, because the merchant is more mobile than the farmer.

### **C. Territorial Monopoly as a Foundation for Coercive Rule**

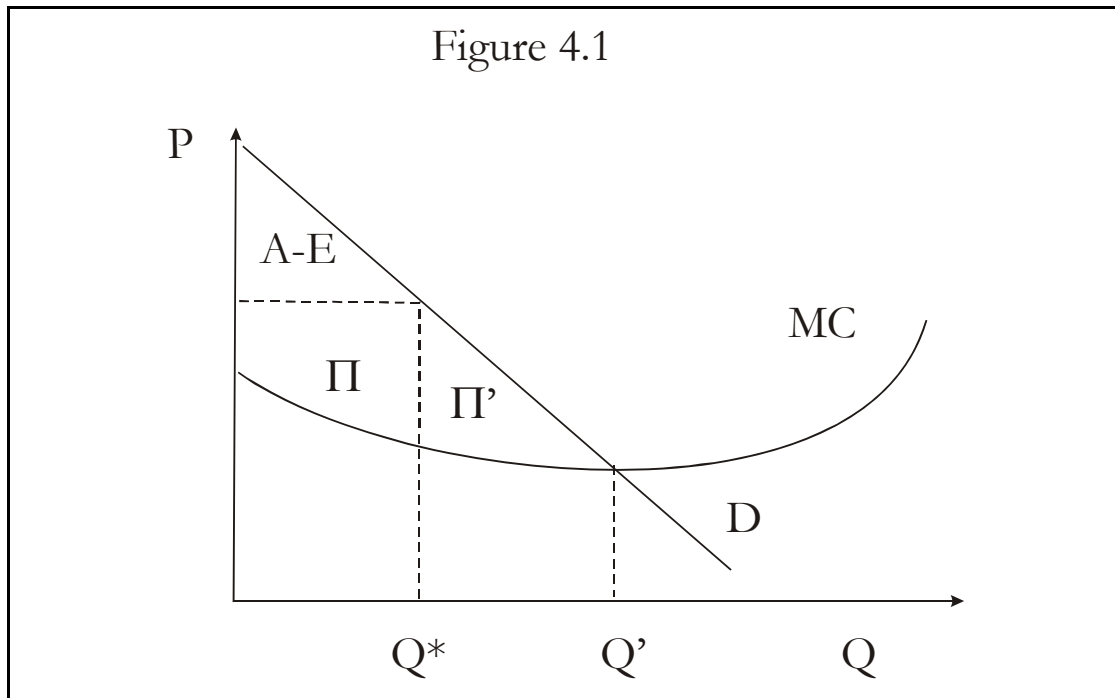
Economists devote a good deal of their time to thinking about settings in which customers may acquire the same services from a variety of organizations and exit costs are low. In such cases, no organization and no territorial government can demand a higher price for its services than any other, whether in cash or kind. In cases in which an organization provides an important, unique service, a much higher price can be charged, because in monopolized markets, customers must pay "the price" or "do without."

Figure 4.1 depicts the pricing decision of a local monopolist that charges a uniform price for its services, modified slightly to take account of the possibility of exit. Here, one can imagine a water

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<sup>29</sup> Even greater exit would occur under some asymmetric theories of behavior under uncertainty. Avoiding possible losses may be considered to be more important than obtaining possible gains.

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 monopolist. The highest possible uniform price reduces water user net benefits from a maximum of  $A-E + \Pi + \Pi'$  to  $A-E$ , the level which could be obtained from alternative sources of the water in other communities. If the price is set any higher, the farmer would sell his land and move, although prices would have to be very high to induce abandonment of fertile farmland and buildings. In such cases, the quality and extent of fixed assets partly determine exit costs.

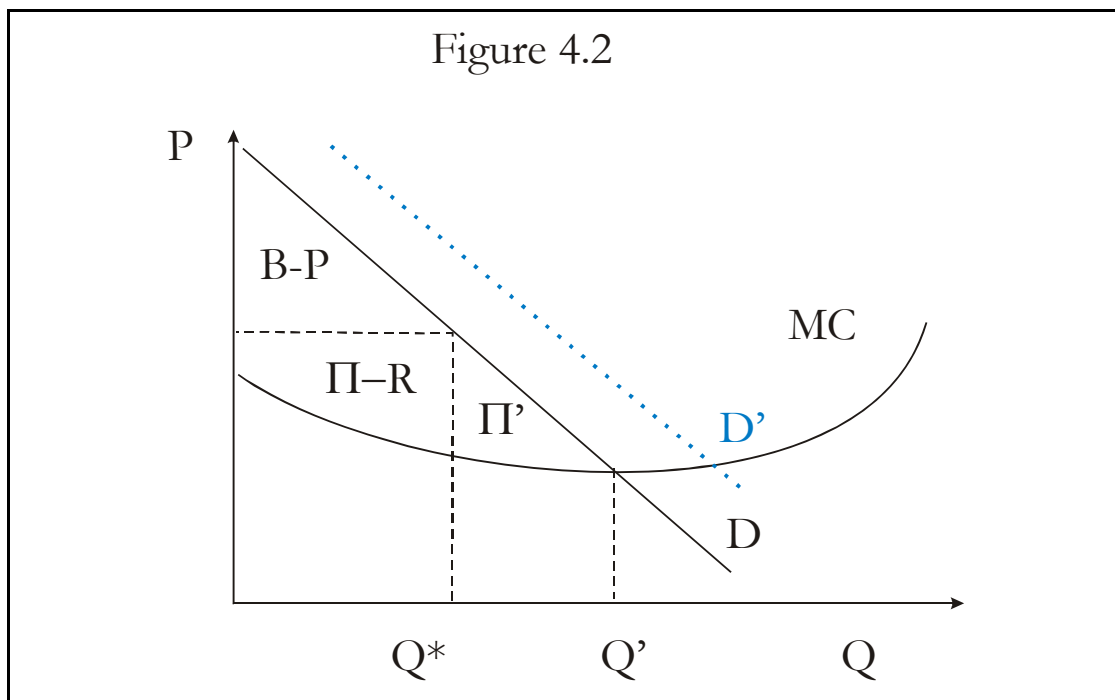


Monopolists are often said to extract “rents” (net benefits or profits) from their customers by controlling access to their services. The monopolist of figure 4.1 can be said to have “extracted” monopoly rents (profits) equal to area  $\Pi$  from its consumers.

It bears noting that the rents extracted from consumers may involve more than a simply transfer of money from customers to the monopolist’s treasury. In cases in which money economies are not well developed, a monopolist organization may find it useful to accept a combination of money, farm output, hours of work, and deference to the organization’s leadership as payment for the monopolized services. Such pricing can generate significant improvements in the resources available to the water monopolist and in the psychic rewards associated with leadership positions in

the organization. Deference, for example, may be valued greatly by the monopoly's leadership, yet may not be directly purchased in markets.

It also bears noting that "all or nothing offers" and price discrimination potentially allow a monopolist to increase its net receipts by up to the amount characterized by area  $\Pi'$ . In either case, the price paid for similar services varies among consumers. Some customers value the service more than others (have more inelastic demands), have less attractive exit alternatives, or can provide the water monopoly with especially valuable services. There may well be inequality before the monopolist's "law" when price discrimination is feasible.



Monopolists have a greater ability to impose rules on their client-customers, than non monopolists, because exit options are more limited. The logic of table 4.1, however, implies that monopolists may have to reduce their money price and profit somewhat to compensate their customers for rule-following behavior. In such cases, imposing rules is profitable for monopolists only if the rules reduce production costs or increase demand enough to offset the cost of inducing rule-following behavior. Figure 4.2 illustrates the case in which the demand for services is increased by changes in the rules. Requiring orderly queues and refusing to bargain over posted prices may be said to increase effective demand by reducing transactions costs.

Note that the ability of a local monopoly to impose rules in such cases arises not from the exercise of military power (although some police power may be necessary to protect their claims to their monopolized service), but rather from their ability to deny access to extremely valuable services and the inability of their customers to substitute services from other organizations (exit). If a person fails to pay for water, he or she might face dehydration or starvation in the future. If a person fails to pay their dues to a defensive-wall cooperative, he or she may be banished from the walled community, and so lose all to roving bandits.

In cases in which more than one organization has monopoly power in a territory, more than one organization will be able to impose rules on the residents of that territory. There may also be sub-territories in which other smaller monopolists benefit from imposing a few rules on their client-customers.<sup>30</sup> There tends to be both a maximum and minimum efficient sized service district for a given technology, because the cost of the services varies with the technologies of production and distribution. By controlling the magnitude and mix of payments required for access to its services, the governing bodies of important local monopolies (and cartels) can exercise significant control over all who live in its service territory.

#### **D. Encompassing Interests, Rent Extraction, 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. Rent extraction can be increased, for example, by monopolizing several critical services, rather than just one. Rent-extraction can also be increased by reducing the availability of substitutes by blocking the entry of rivals in various ways. Such methods for increasing rent extraction tend to make community members worse off by shifting the terms of exchange in favor of the ruling organization—although

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<sup>30</sup> Even firms in fairly competitive markets can also impose rules on their customers: a grocery store or restaurant may demand “suitable attire,” and/or may 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. In competitive markets, however, the rules must directly or indirectly benefit customers, or they would shop elsewhere. For example, limiting shopping hours must allow firms to provide their services at lower costs to the customers or improve ambiance for their customers. Dress codes may similarly be imposed to 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 when eating one of its hamburgers, although restaurants with monopoly power might be able to do so.

there are, as noted above, limits to a monopoly organization's ability to extract rents from its client-customers.

Perhaps surprisingly, there are also methods for increasing rent extraction opportunities that provide additional benefits to a community's residents. For example, the demand for a monopolist's services can be increased by reducing transactions costs and increasing client-consumer income. Such effects gives regional monopolists what Olson (2000) calls an "encompassing interest" in their communities' economic development. For example, a local monopolist may undertake or subsidize the construction of a network of roads to reduce production and distribution costs for all consumers and non-rival firms in its territory. Similarly, a regional monopolist may provide dispute resolution and other legal services, because "law and order" increases local prosperity and the demand for its services.

Any public or private service that directly or indirectly increases net revenues for the monopolist may be provided.

### *On the Provision of Law and Order by Local Monopolists*

It is interesting to note that "dispute resolution services" can be provided at a relatively low cost by large regional monopolists, because their "rulings" can be enforced by simply threatening to increase prices or deny services to those who fail to follow its rulings.

To produce dispute resolution services, a monopolist may create and delegate the authority to an arbitration board and head arbitrator. A network of more or less permanent locations and times may be established at which disputes will be evaluated and judged by company arbitrator-judges. Again the logic of rational conservatism applies. It will normally be the case that the rules enforced by local authorities will be based on older successful bodies of law rather than invented whole cloth for each dispute or each community. The rules may modified slightly for the cases or communities at hand, insofar as doing so increases the surplus of the monopoly organization.

Consistency can be assured by writing down the rules and allowing appeals of particular decisions that end with a single individual or committee, such as the governor (formeteur or successor) or supreme court. Such procedures also tend to reduce the risks associated with arbitrary treatment by ruling authorities for much the same reason that written contracts reduce risks from relationships among organizations and customers. It clarifies what is expected and reduces the extent to which the rules may be changed after decisions based on them have already been made.



Predictable, rule-governed, enforcement systems tend to make retention of a community's residents easier for community rulers, although, for reasons already noted, equal protection of the law may not. Deference to established laws and court decisions tends to reinforce institutional conservatism, because "the law" in most countries is regarded as a long-standing collection of rules and procedures with a high degree of functionality and normative support. The long-standing rules that emerge from such procedures are often regarded as "natural laws" or "rights."

It bears noting that the earliest known written laws are from the Euphrates valley where governments were based at least in part on monopolized irrigation networks. These early 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 rules of many other communities in the Middle East, including what became Jewish law (Finkelstein 1968–69).

Religious services were also among the core monopoly services provided by many ancient governments (Bailkey 1967). The monopoly power of state religions allows them to impose rules on believers and nonbelievers by espousing universal norms for behavior. "Thou shalt not ..." Formal laws and norms are often enforced through religious court systems. Such courts were run, for example, by Catholic, Jewish, and Islamic churches during the medieval period. When supernatural threats are believed, they can be a cost-effective method of encouraging compliance with the rules, and also for reducing resistance to the decisions reached in court proceedings. When religious services are not directly provided by governments, religious monopolies are often supported by regional governments. The state-supported church, in turn, normally reciprocates by encouraging support for the government. Even today, the sovereign of England is the head of the Church of England, and hold the title "Supreme Governor of the Church of England."

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 community rules (laws) increase the prosperity of a community. Stable sets of community rules can solve coordination and externality problems. They can reduce the extent and cost of unproductive conflict among persons and organizations in the community. They can also facilitate (and encourage) long-term planning by individuals and organizations by increasing expected returns and/or reducing the variance from capital investments and specialization. The value added by "law and order" services is emphasized in the early enlightenment contract theories of the state developed by Hobbes (1651) and Locke (1689) and in contemporary game theoretic explorations of shifts from anarchy to civil society, as in Nozick

(1974), Skogh (1982), and Volckart (2000). There is also a substantial body of empirical research in economics that links the provision of law and order services with increased national income.<sup>31</sup>

Providing such services tends to encourage the development of prosperous communities, which increases potential rent extraction for ruling monopolists by increasing the demand for their services.

### **E. Military Threats, Rent Extraction, and Defense**

As profits and deference are produced, rivals inside and outside the organization may attempt to take over the leadership posts in regional governments in order to enjoy the rewards associated with those positions. Such take over efforts may include threats of violence. Both formateurs and their successors naturally take steps to avoid both internal and external overthrows. With respect to the latter, they will defend themselves, their organization, and their territory. They do so by organizing defensive teams and investing in defensive capital. The organization may fortify its offices and production facilities. The monopolist's team members and customers may be encouraged to turn out and defend the organization's capital assets (the irrigation system, wind mills, buildings, etc.).

An implication of the analysis of chapter 2 is that the cost of defensive teams can be reduced by encouraging militaristic norms (the warrior ethic) and other forms of loyalty (community patriotism) that tend to promote rule-following behavior, toughness, and a willingness to sacrifice for the government and its community. Defensive norms, teams, and capital can also be used to drive up exit costs, which allows greater penalties to be used to assure compliance with its rules adopted to defend the government's interests.

### *Artificial and Natural Monopolies*

The infrastructure and teams organized to provide defense can also be used to increase an organization's monopoly power.

Economists often distinguish between natural and artificial monopolies, and this distinction is of some relevance for the present analysis. Natural regional monopolies tend to emerge when there are significant economies of scale in production that a regional market supports only a single efficiently sized firm, or when particular skills or natural resources are available from only 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,

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<sup>31</sup> See, for example, Keefer and Knack (1995, 1997) or Feld and Voigt (2006).

theology, dispute settlement, urban planning, education, sanitation services, and social insurance. Regional monopolies also occur when a single organization or cartel controls a critical natural resources such as an artesian well or salt mine.

In contrast, artificial monopolies arise when an “entry barrier” is created that allows only privileged organizations or persons to provide particular services in the region of interest. For example, religious services, exports and imports, and military training are often monopolized by making rival organizations illegal. Such barriers to entry tend to induce competition to join privileged groups, which can further increase income, authority, and support within the privilege organizations and groups. The possibility that such barriers can be created naturally induces competition for the government’s favor, which can be a useful source of in-kind services for regional governments. Monopoly privileges may also be sold or rented to other organizations as an additional source of government revenue (Congleton and Lee, 2009).

Artificial monopolies can be created by government policies. A monopolist’s rule making and dispute resolution services, for example, can be used to enforce requirements that producers of particular products belong to specific clubs or families, or obtain special permission from the ruling organization. Rivals may also be prevented from serving particular markets, by forcibly closed them down through force of arms. Monopoly power can also be increased by adopting and enforcing rules that reduce the viability of potential rivals (Lott 1990).

To help pay for fortifications and defensive teams, a monopolist may also rent out well-defended positions to persons in the community when military risks are significant. Indeed, community-wide defense services is another area in which monopolies may emerge. Persons whose life or property are at risk are willing to pay very high fees for access to a fortress or redoubt when external security risks are high, because exit options are of little value at such times. Those seeking protection are willing to pay essentially any price, which may include promises of cash payments and other services in the future. The implied offer is essentially “your money or your life,” although in this case, the monopolist offers a service, rather than a threat.

All these effects imply that a regional monopolist with military power will tend to have a greater organizational surplus than ones without such power. The organization of military force helps monopolists protect and extend their monopolized markets. The highest levels of dispute resolution will tend to be those run by the physically strongest organization in a given territory, because there are economies of scale in making credible military threats. In such cases, “might” may literally be said to make “right.” Rule-enforcement may be enhanced by including physical punishments, as well

as denial of services. The confiscatory powers and credible threats associated with military power also make it easier for such organizations to obtain the resources required to sustain their team members and to weather temporary setbacks.

Military power thus tends to increase organizational viability in the short and medium term, as long as mass exodus is not induced and the cost of producing it is not too great.

### *Military Power and the Dissipation of Monopoly Rents*

In the long run, however, success tends to intensify efforts to overthrow territorial governments. The greater are the local monopoly profits and the more prosperous is a given community, the more it pays rivals to invest in internal and external takeovers (Thompson 1974, Tullock 1974). The former may undermine stable governance in the long run, as noted in chapter 3; the latter may cause a territorial government to be absorbed into another at great cost to its leaders and their communities.

The winner-take-all nature of external takeovers implies that when conflict occurs, it will generally consume substantial resources. To be prepared for wars of conquest, requires significant investments in training, fortifications, and arms. The intense short-term nature of wars also tends to attract the full attention of the government, which tends to reduce its productivity in other areas. Monopoly fees and tariffs tend to rise and productive investments tend to fall as governments shift resources from peaceful to military purposes in order to resist the takeover efforts of rival organizations.

Contest 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). History suggests that such risks are not simply a matter of conjecture. There are many cases in which prosperous communities have been plundered by roving bandits and annexed by rival armies. The border conflicts of medieval and early modern Europe often took European kings and princes to the verge of bankruptcy (Ertman 1997, Ferguson 2002).

The all-encompassing nature of conflict during times of intensive border conflict helps remind us that military power is not likely to provide an explanation for the origin of civil society, although it does enhance the ability of regional monopolists to impose rules on persons outside their organizations. Fortunately, the same natural barriers that increase regional monopoly power and increase exit costs also provide a good deal of free defense for many communities around the world. Natural defenses such as mountain ranges, deserts, rivers, and oceans simultaneously increase

monopoly power and reduce threats from rivals, which reduces the need for military organization. Great empires have often been assembled by overcoming such national defenses, but they did not create the prosperity that made empire-building a profitable activity.

## **F. Conclusions: The Form, Basis, and Limits of Territorial Governments**

The ability of territorial monopolists 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 organizations. Few organizations last as long as territorial governments, and those that do, such as religious organizations, often have similar monopoly powers and rule-imposing abilities. Economies of scale in the core services of major territorial monopolies often require, or at least support, relatively large organizations. Territorial governments are often the largest organization within the territory of interest.

The rules imposed by governments are still backed by threats that include denial of services (banishment from the community) and threats to take property, life, or limb forcibly. However, 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, a territorial monopoly that has its own interests at heart often has good reason to increase general prosperity, insofar as it profits directly or indirectly from greater demands for its services.

The rules enforced by regional governments tends to be stable, but unequal. A rent-extracting regime has little interest in civic or economic equality for its own sake. Some persons are more important to their organization than others, and such persons may be privileged in various ways. Opportunities to profit from price and rule discrimination and from the direct sale of market privileges imply that the prevailing rules will be substantially unequal.

In other respects, regional governments are predicted to be very similar to other durable organizations. 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 (and external) incentive problems. As true of other organizations, their policymaking architecture will tend to be drawn from existing templates, among which the king and council template is likely to be prominent. The balance of authority within that template will reflect the origin of the governing organization. If founded by a single formateur, a good deal of policymaking authority initially will reside with the

organization's chief executive—mayor, governor, or king—and somewhat less authority will tend to be available to its council—town council, cabinet, or parliament. If founded as an alliance of local residents or a confederation of regional governments, the council will tend to be the dominant policymaking authority and the chief executive officer will, for the most part, simply implement council decisions.

As true of other organizations, durable territorial governments are predicted to have standing procedures for making policy decisions and for replacing their leaders. Standing procedures for making policy decisions tend to remain in place, because of the advantages that those rules have for government leaders and because of uncertainties associated with experimentation. As a consequence, the persons inhabiting the policymaking offices of durable organizations normally change more frequently than the core procedures of governance. As the English saying goes, “the king is dead, long live the king.” Succession problems will often be solved by allowing kings and/or councils to appoint one another and through mechanistic succession based in family bloodlines. Even in cases in which an internal overthrow takes place, the preexisting procedures of governance are predicted to be retained for the most part.

### *Relevance of Analysis for European History*

These predictions are consistent with most accounts of regional governments in recorded history, which it must be acknowledged occurred somewhat after territorial governance and large prosperous communities emerged. There is substantial evidence that durable governments had stable procedures of succession and stable public policies. There is evidence that privileges of various kinds inside and outside government were commonplace, and to a significant extent engineered by important regional governments with monopoly churches. There is evidence that mobility was a concern for governments and a balm for community residents. Natural barriers thus influenced the course of political and economic development (Jones 2003). Very large migrations also occasionally took place to escape from governments with reputations for arbitrary rewards and harsh punishments. There is substantial evidence that the king and council template for governance was widely used.

Of greater importance for the historical purposes of this book is that chapter 4 explains the core architecture and policies of national governments in late medieval Europe and Japan. National governments in Europe and Japan emerged in this period and so were relatively new organizations. In cases in which a single person can be said to have organized the amalgamation of the territories

governed, the CEO of the subsequent government tended to be dominated by the formateur, as with the kings of England, France, and Sweden and the Shogun of Japan. In cases in which the government was initially organized as a defense alliance, a council of formateur representatives tends to be the dominant chamber of government. The Netherlands was founded in the sixteenth century as a defense alliance and initially had a relatively strong parliament and weak executive (stadhouder). Similar balances of authority are also found in Switzerland and the United States.

A broad variety of barriers to trade were adopted within and among the medieval kingdoms. These were often used as revenue sources for the state of interest, as with tariffs and sales of monopoly privileges. Medieval laws also treated members of different “classes” of families differently. Nobles and royals had many privileges. European councils and parliaments were largely populated by “blue bloods,” persons from wealthy and privileged families, many of whom held their seats in government as an inherited birthright. Many positions in the military and in the bureaucracy were reserved for privileged families. Slave and serf families had restrictions that others did not. The members of families in between these extremes had intermediate privileges and restrictions.

By the end of the medieval period, the economic foundation for territorial governments had evolved substantially toward tariffs and property taxes, which can be thought of as charges for defense services, although many governments also had significant monopoly power over dispute resolution services, transport networks, potable water, and sanitation. There was normally a state church with monopoly power over religious and moral theory. “Deviant” ideas (new entrants) were discouraged by widespread norms of deference to religious and state authority. The authority of the medieval church and state were, after all, the consequences of divine intent. To challenge their authority was blasphemous and traitorous. Informal religious and cultural sanctions were further buttressed by censorship and treason laws enforced in religious and state courts.

## **Chapter 5: Constitutional Exchange and Divided Governance**

The theory of territorial governance developed in the previous chapters provides an explanation for the existence of territorial governments, why they tend to be rule driven, and why we rarely observe a ruler without an advisory council or a ruling council without a chief executive officer. It also explains why every government tends to have its own relatively stable “law of the land,” and why that law will not generally be the same for all members of the communities ruled. The rules are partly informal (or spontaneous) and partly the result of conscious efforts to adopt and enforce policies that advance organizational interests and, more specifically, the interests of formateurs and their successors.

To say that governments are constrained by the advantages of stable rules and their own institutional conservatism is not to say that the policymaking procedures and policies of governments are entirely determined by standing routines. Many persons inside governments will have some discretion to make informal adjustments to standing policies at the margins. Moreover, formal reforms of the core procedures of governance may be adopted when they appear to be useful—that is to say, when they appear to benefit the members of the organization’s rule-making bodies.

The multidimensionality of policy and policymaking authority implies that many reforms of standing policymaking procedures can be adopted through bargaining and exchange. Specific divisions of authority have more or less predictable effects on policy outcomes, which provides a possible basis for constitutional bargaining and reform. Authority-sharing arrangements can also serve as a method for obtaining additional resources or services from person’s affiliated with an territorial government, as a method of reducing losses from internal and external conflict, and as a method of obtaining preferred policy outcomes within already divided governments.

Within the unitary hierarchical governments favored by Hobbes and many others, there are few opportunities for constitutional exchange, because by definition, only one formal assignment of policymaking authority is possible. The sovereign always retains complete control over policy. Even in such organizations, however, it is possible to reallocate delegated authority among offices to take advantage of the talents and interests of persons in the organization, although such changes formally require the approval of the sovereign and can be changed by the sovereign at will.

Within divided governments, however, the degree of control and assignment of authority among policy areas can be varied among persons and centers of policymaking authority. For



example, within the king and council template, authority can be divided between the king and council, policy-by-policy. The authority of individual council members can also be varied by, for example, using weighted voting, giving subsets of council members additional agenda control, or by dividing the parliament into separate chambers with more or less veto and agenda control.

These institutional possibilities create numerous possibilities for dividing up and shifting policymaking authority. And, as in ordinary markets, it will at least occasionally be possible for policymaking authority to be “reallocated” among insiders in a manner that advances the interests of all those whose authority is changed. The result will often be forms of government that depart from the near polar cases of king-dominated and council-dominated governance.

This chapter analyzes gains to trade that can be realized by sharing policymaking authority and by reassignments of agenda control and veto power within the king and council template. It notes advantages and disadvantages for the parties involved in the constitutional bargaining, and demonstrates that cases exist in which a reassignment of authority can advance the interests of all those at the bargaining table. The analysis focuses on standing territorial governments that have passed beyond their formateur stage and so are led by persons who take the organization’s present assignment of power as “given.” In such cases, the initial assignments of policymaking authority can be regarded as initial endowments of “political property rights” that can be traded, whether the status quo distribution of authority is characterized in writing or not.

### **A. Shared Sovereignty as a Method of Increasing Organizational Resources**

The persons who have the authority to adjust an organization’s standing procedures for making policy decisions are normally all insiders who occupy the highest policymaking “offices” within the organizations of interest. Insiders, as noted above, have many reasons to support the existing procedures and assignments of policymaking authority, although this does not mean that they are opposed to all changes in the procedures through which their organization’s policies are chosen, nor does it imply that they are always opposed to changes in the procedures through which high “officials” in their organization are selected. Institutional conservatism simply implies that they will be opposed to most such reforms and tend to prefer modest to major reforms.

#### *Sharing Policymaking Authority To Obtain Organizational Resources*

Organizational effectiveness can occasionally be increased by sharing policymaking authority. For example, in the case of our illustrative pear cooperative and cherry-picking firm, prospective

team members with ladders or who are especially adept at climbing trees may be more willing to participate in the annual harvests of these organization, if they have some veto authority over the use of the ladders or the trees to which they are assigned. Exit is, of course, always possible if they are misused, but risk of damages (broken ladders and legs) can be reduced by giving such valuable team members the right to participate in decisions regarding the use of their ladders and assignments to particular tree tops.

Similarly, a regional government that confronts an external threats from pirates or Vikings may benefit from the use of commercial ships in defense of their communities. The owners of such ships, however, may be unwilling to allow their ships to be entirely subject to the command of the regional government. They might fear, for example, that the government would assign their ships to the most dangerous missions, while holding the government’s own ships in reserve. Granting the commercial ship owners some authority to veto or at least influence how their ships will be used may make them more willing to allow their ships to be used for regional defense.

Table 5.1 illustrates patterns of risk and rewards that can lead to authority-sharing bargains in such cases. The initial state is the one characterized by the upper left-hand cell in which the resource is entirely controlled by the potential team member. The organization’s leadership is better off if it obtains complete control over the prospective team member’s resources, than if it obtains shared or no control ( $14 > 12 > 10$ ). The prospective team member is better off with shared control than with complete or no control ( $10 > 8 > 6$ ). Retaining complete control requires sacrificing advantages from team production. Giving up complete control, however, places his or her resources at greater risk than under shared control.

		Organizational Leadership		
		No Authority	Shared Authority	Complete Authority
Potential Team Member	Complete Authority	8, 10	--	--
	Shared Authority	--	10, 12	--
	No Authority	--	--	6, 14

There are gains to trade that can be realized by sharing policymaking authority in a fairly narrow range of the organization’s activities. Both the organization’s leadership and the prospective team

member benefit from shared control in this case. The organization has additional output (more pears, more cherries, or better defense) and the prospective team member profits from the advantages of team production, while avoiding some risks associated with delegating control to an organization's leadership.

Similar gains from sharing authority may also exist when organizations or communities decide to merge their governments to realize economies of scale, diversify risks, or reduce transactions costs. In such cases, sharing policymaking authority allows the interests of the merging organizations or communities to be protected against rent extraction by the other, while the additional joint output or reduced risks make governmental officeholders better off. (The latter is, of course, necessary for a voluntary exchange of authority to take place at the level of organizations or governments.)

## **B. Shared Sovereignty as a Method of Reducing Losses from Conflict**

Similar gains to trade may also arise in settings in which control over resources is disputed. Conflict over control over resources does not always involve violence or threats of revolution, but nonetheless tends to reduce organizational output and surplus by diverting time, attention, and other scarce resources from more productive activities. Losses can arise from both "civil" and "uncivil" conflict. Such losses are naturally taken into account when an organization is initially formed, and when reward and governance systems are reformed through time.

The game matrix characterized in table 5.2 characterizes an asymmetric contest in which two parties clash over the control of some policy, territory, theology, or ideology. The case of interest is one in which the weaker of the two parties is able to resist the stronger, and complete control is costly for the stronger party to implement. The Nash equilibrium of this game implies that both parties devote resources to the contest, because each party's private payoff increases as it invests more resources in the conflict, other things being equal. The weaker party benefits from resisting the stronger party, because resistance achieves a better result than unconditional surrender, which may simply be the pride of having resisted the takeover.

The Nash equilibrium implies that existing procedures for adopting policies are suboptimal for both the strong and weak parties. Eight units of resources are wasted at the Nash equilibrium [ $8 = (6+14) - (2+10)$ ]. As in a conventional rent-seeking contest, both parties would be better off if they could alter the contest so that they achieve the same result without using so many resources in conflict.

**Table 5.2**  
**Asymmetric Power Game**

		<b>Stronger Party</b>		
		Little Aggression	Moderate Aggression	Intense Aggression
<b>Weaker Party</b>	Little Resistance	<b>6, 14</b>	3, 16	0, 18
	Moderate Resistance	7, 10	4, 12	1, 14
	Intense Resistance	8, 8	5, 9	<b>2, 10</b>

One possible solution is to revise the rules of the game in a manner that changes the nature of the conflict in a manner that benefits both players (Buchanan 1975, Congleton 1980, North 1987). For example, the leader of a conquering army may exchange local autonomy to well-run communities in exchange for veto power over local foreign policies and tax (tribute) payments in order to avoid an expensive conquest. Alternatively, a new council representing the interests of the weaker party might be formed and given limited control over future policy with partial agenda control or veto power (Congleton 2004b, 2007a). Or, the weaker party may be given seats in an existing council and/or additional votes within that council. Insofar as conflict within political institutions tends to be less costly than on the battlefield (or within an organization’s production teams), adopting such procedures tends to be advantageous for both parties.<sup>32</sup>

An effective collective choice mechanism does not eliminate all losses from conflict, but reduces its cost by inducing more “civil” forms of rivalry (Congleton 1980). Persuasion and coalition building may replace warfare on the battlefield or assassination and counter-assassination (Hobbes 1959, Bush 1972, and Buchanan 1975). The same logic also implies that changes in circumstances that create new conflicts may also induce changes in a preexisting distribution of policymaking authority. Modest procedural reforms do not require existential threats to advance the interests of pragmatic governmental leaders.

### **C. The Geometry of Divided Authority within King and Council Governments**

Within the king and council template, policymaking authority can be shared in many ways and control over particular policy areas can be subdivided in even more ways. For example, a person or

<sup>32</sup> See Congleton, Kyriacou and Bacaria (2003) for an analysis of bargaining between central and regional governments.

committee might have complete control over specific policy areas and none in other areas. Control may be shared in some areas and complete in others.

Shared control may entail different assignments of veto power and agenda control over some or all policy areas. A person or committee may be said to have partial control if he, she, or they have veto power, but not agenda control, or when veto power is distributed among several decisionmakers or centers of authority. Complete control over an area of public policy can be said to exist if a single decisionmaker or decisionmaking body has complete veto power and agenda control in that area of policy. Such persons can choose which possibilities to consider and unilaterally decide whether to accept or reject them.

Constitutional gains to trade between the king and the council emerge when reassignments of agenda, veto power or jurisdiction are mutually beneficial. Such gains can emerge entirely within the domain of policy assignments or may arise when money (tax receipts etc.) or other services are traded for authority. There are two choice settings of interest. In some cases, the parliament or council may not have its own policy agenda. In others, it may. With respect to the former, Black (1948) and Arrow (1963) demonstrate that committees that choose policies using majority rule will not always be able to reach a final decision because of majoritarian cycles. With respect to the latter, there are cases in which council member ideal points are identical, linear, or symmetrically arrayed, in which case the cycling problem will not exist, as noted by Black (1987) and Plott (1967). In such cases, the council will make consistent recommendations and consistently exercise its veto power. Such alignments produce “decisive councils,” rather than nondecisive ones.<sup>33</sup>

### *Veto and Agenda Control with Decisive Councils*

Consider, first, a near polar case in which the king confronts a small decisive council. An example of a “decisive” alignment of council preferences is depicted in figure 5.1, with the three committee members’ ideal points lying on a straight line and denoted with the capital letters *A*, *B*, *C*.

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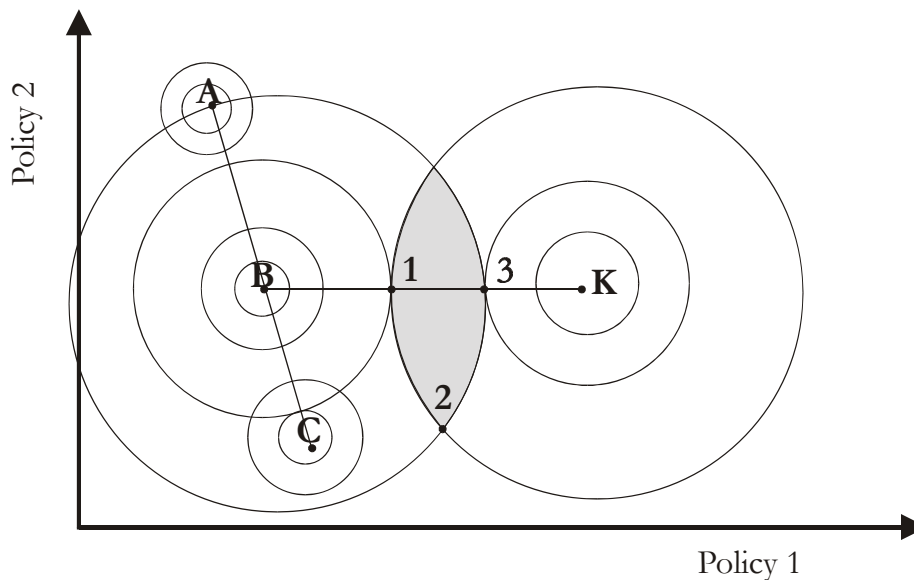
<sup>33</sup> The cyclic majority problem can also be avoided through various institutional devices, as has been noted by Shepsle (1979), Shepsle and Weingast (1981) and Baron and Ferejohn (1989), among others. In cases in which cycle majority (and the related majority coalition instability) problems are avoided through institutions the analysis would parallel that of the decisive committee analysis below. The cyclic majority examples indirectly suggest that an executive (king) may profit by blocking reforms that eliminate cycles or stabilize coalitions and so strengthen the council. Although there is considerable evidence that parliaments and royal councils are reasonably stable in their policy preferences, there is also evidence of cycling through time (as with tax reform) and also of executives playing factions against each other.

The ideal point of the king is denoted with the letter K. Assume that initially the king has complete control over both dimensions of policy and that the initial policy is thus his ideal point, K.

The king is assumed to exercise complete control over two separate dimensions of policy and is considering transferring some veto power or agenda control to the council. Whenever political circumstances are stable, the king can shift either veto power or agenda control to the council at essentially no cost. Note that if the king gives the council veto authority and retains agenda control, he can propose K, which confronts the council with a “choice” between K and K. Because only K is possible, K continues as the law of the land, regardless whether the council vetoes the policy or not. On the other hand, if the council is granted agenda control, rather than veto power, the king can veto any proposal made by council to move away from K.

In stable times, retaining either agenda control or veto power is sufficient to protect the king from reforms that would make him worse off.

Figure 5.1. Effects of Veto and Agenda Power



The other polar case is that in which a decisive council initially has both agenda control and veto power. In that case, the initial policy is B (the median council member's ideal point). In stable circumstances, a decisive council can also share policymaking authority with the king at little cost. Note that if the council gives the king (CEO) agenda control, the pivotal council member can use its veto power to block any policy proposal by the king that makes the median council member worse

off. On the other hand, if the council gives the king veto power and retains agenda control, it can simply propose that policy *B* be continued, and policy combination *B* will remain in place regardless of the king's veto, since *B* is also the reversion point.

Either branch of government's ideal point can be defended, as long as it has either veto or agenda control and circumstances are stable in the sense that the policy preferences of high officials do not change during the period of interest. In stable settings, sharing power with the weaker branch of government is surprisingly inexpensive for the initially stronger branch. The willingness of the weaker branch to "purchase" authority from the stronger, however, would consequently be very limited in stable times, unless the weaker chamber expects more turbulent times to emerge in the near future.

### *Sharing Power with Decisive Councils in Unstable Times*

During unstable periods policy interests may change and power-sharing arrangements will affect the policy adjustments that can be made. Suppose that political circumstances change in a manner that affects officeholder policy preferences. A change ideal points, for example, tends to occur at times of succession, insofar as policy preferences are not entirely induced by institutional factors. Scientific advance may also change policy rankings by producing new estimates of the consequences of policies. Technological advance may allow formerly impossible policies to become possible and necessary.

Suppose that prior to the change in circumstances, the status quo (reversion point) had been policy combination "2" in figure 5.1, which should now be interpreted as the ideal point of the previously dominant branch of government. The ideal points characterized by the indifference curves of the king and council should now be interpreted as those associated with their "new" ideal points. In the absence of a veto by the weaker chamber, the stronger chamber will simply adopt its new ideal point as the official policy of the realm, *K* or *B*, according to which chamber is dominant. However, if the weaker chamber has veto power, it can now block such moves.

The policies that can be proposed by the agenda setter without being vetoed are identified by the shaded lens or football shaped area. Note that the presumed status quo policy combination 2 is preferred by the king to *B*, and by the median council member to *K*. In the new setting, the best result that a king with agenda control can achieve is policy 3, given the veto power of the council. In the converse regime, the best policy that an agenda-setting council can hope for, given the veto power of the executive, is policy 1.

In unstable circumstances, the consequences of alternative assignments of veto power and agenda control are no longer identical. The party with agenda control does better relative to the party with veto power in the illustration, although neither party is able to obtain their ideal policy.

These cases also demonstrate that policy tends to be more stable within divided forms of the king and council than in polar forms, because shifts in policy tend to be smaller. The geometry of figure 5.1 implies that the policy shifts induced by political shocks are often smaller and cannot be larger than those which would have been adopted under either polar form of governance. (A movement from 2 to either 1 or 3 is smaller than a movement from 2 to either K or B.) Insofar as stable policies tend to promote economic growth by, for example, making the legal and regulatory framework more predictable, divided governments may help promote economic development in an uncertain world.

### *Veto Power and Agenda Control with Nondecisive Councils*

Consider next the case in which the council is *nondecisive* in the sense that no pivotal voter exists. The geometry of figure 5.2 illustrates a case in which the preferred policies of council members are such that they cannot make a final decision because of majoritarian cycles. Cycles of this sort are observable to those outside government as a lack of decisiveness. Such councils may be regarded as weak, factional, or disorganized. Every possible proposal can be defeated by some counter proposal.

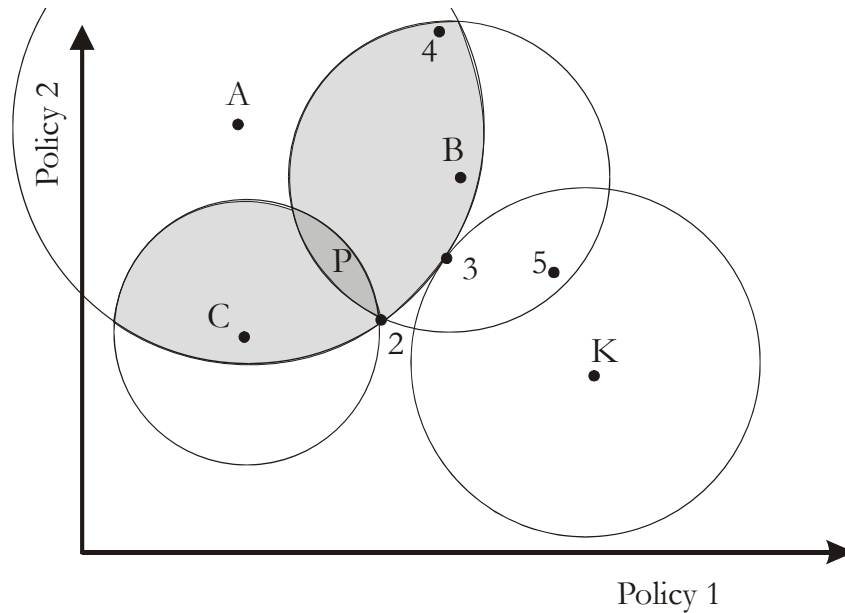
In such cases, it can be argued that only one division of agenda control and veto power is possible, because nondecisive councils can exercise veto power, but cannot exercise agenda control. Given a nondecisive council, the executive branch can use agenda control to obtain very good results for the king (or queen).<sup>34</sup> To see this, suppose that a political or technological shock has changed the ideal points of the council and/or king so that the status quo policy is neither the ideal point of the king nor in the Pareto set of the council. For purposes of illustration, assume that the status quo is again policy 2, which is Pareto-dominated for council members by policies within lens-shaped area P. However, if the council uses majority rule rather than consensus to make decisions, a king with agenda control can propose policy 3, which will secure majority approval over policy 2.

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<sup>34</sup> This point was first developed by Schap (1986), although his analysis differs somewhat from that developed here.



Figure 5.2 Agenda Control with a Weak Council



Policy combination 3 is a stable outcome only until the king can propose another policy. Indeed, the king can propose a series of policy proposals that allows his ideal policy combination to be realized—notwithstanding the veto power of the council (McKelvy 1976). In effect, the king plays the three council factions off one another, which occasionally require the king to sacrifice his own interests strategically in the short run, as with proposal 4, rather than 3, which allows the more desirable policy combination 5 to be achieved in the next round.

How long such governmental deliberations might take in real historical time is beyond the scope of the present analysis, but this possibility suggests that a strong forward-looking king faced by a weak (nondecisive) council can offer veto power in exchange for council acquiescence on other pressing issues or as compensation for service to the sovereign at a very low cost in both stable and unstable circumstances. Nondecisive alignments of council interests allow kings to use agenda control to achieve their own ends, perhaps surprisingly, without undermining the council's veto power over new policies.

### *Constitutional Barter*

A forward-looking council can rationally make concessions to the king or provide extraordinary services in exchange for veto power or agenda control, whenever they anticipate future circumstances in which the council will be both decisive and able to constrain the choices of the king. (Indeed, a council or parliament may modify its internal procedures to make it more likely to be decisive.) In the long run such constitutional contracts can provide a future decisive council, however unlikely, with greater authority over public policy than even a hard-pressed king would have agreed to.

As will be seen in part II of this book, such decisive councils did emerge in the eighteenth and nineteenth centuries, as new economic interests, new ideological interests, and new politically active organizations affected the policy preferences of the persons holding seats in parliament.

#### **D. Constitutional Bargaining and Royal Secession**

Another systematic source of drift away from executive control is variation in the talent, age, and planning horizon of kings and queens through time. The bargaining positions and constitutional interests of kings tend to vary during their time in office. The interests of young and old kings often differ because of age and energy, but also because of training, education, and experience. New sovereigns tend to depend more on the judgment of their advisors than experienced sovereigns, and are also less familiar with the biases of their advisors and the negotiating techniques of their councils and parliaments. Young kings have world views that are shaped by their tutors rather than by past experience in real policy settings. Older kings may also rely heavily on their advisors when their health fails or their interest in day-to-day politics fades.

The vagaries of training, tastes, and genetics imply that the talent and interests of successive kings and queens also tend to vary through time. (Substantial evidence exists of reversion toward the mean in the children of talented persons.) Countries thus can be a bit fortunate or unfortunate in the persons who accede to the throne at times when major reform issues arise, as historians often emphasize.

In contrast, competition for membership in the royal council and parliament tends to be relatively open and intense, so the talent of councils and parliaments tends to remain relatively high and constant through time. A disinterested or relatively untalented king may be out-bargained by his relatively energetic and talented prime minister and/or members of parliament. Even if an

occasional ambitious and talented king is able to recapture most the authority given up by their less engaged forebears, genetic trends produce a systematic drift away from direct royal control of public policy—other things being equal.

Executive councils are normally the direct beneficiaries of royal delegation during such periods, especially prior to the nineteenth century. Parliaments, nonetheless, indirectly benefit from genetic trends, insofar as executive councils are chosen from members of parliament, and prime ministers need continued support in parliament to obtain the policies required to keep the sovereign's support. Parliamentary bargaining power also tends to increase in cases in which the next person in line for the crown is less than perfectly obvious, because this allows the terms of the next "elevation" to be controlled by parliament. Parliaments never unexpectedly dies, although important members may.

### **E. Divisions of Authority through Time: Random Walk or Trend?**

To this point, we have explored three possible settings in which policymaking authority may be adjusted through a process of constitutional exchange. At any moment in time, most such gains from trade will already have been realized, because doing so advances the interests of most of the persons involved. New gains from trade may occasionally arise when technologies change, when ideology changes, when the persons occupying high office change, or when new military threats emerge.

*Technological Shocks.* Changes in the patterns of trade or warfare may affect the relative cost of maintaining control over the polity and also the extent of information needed to make good policy decisions. When economic development takes place in towns and cities, the greater population densities of cities allows industrialists, tradesmen, and laborers to more easily organize to resist and advocate public policies. Insofar as the parliament represents those interests more than the king, this tends to favor parliaments in constitutional negotiations. In some cases, it is cheaper to cede a bit more authority to local governments or parliament than to suppress local resistance. When technological advance reduces the cost of overcoming resistance, royal authority tends to be favored. When the complexity of policy analysis increases, the value added by the advice of councilors tends to increase.<sup>35</sup>

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<sup>35</sup> Evidence of the importance of how technological developments may affect political organization is developed in Dudley (2000, 1991) argues that informational technologies can affect the size and scope of national governments. Although his analysis emphasizes technological change rather than the use of advisory councils and parliaments, his analysis of the effects of information technologies is very much in spirit of that developed here.

*Ideological Shocks.* Changes in the positive and normative theories of governance can similarly affect the costs of control and resistance by changing the norms against which current institutions are assessed. Ideological shifts may also reduce the costs of organizing formerly unorganized groups in a manner that increases support for (or resistance to) particular reforms and policies. Moreover, as ideology increases in importance, councils are more likely to be decisive, because liberal-conservative political spectrums tend to be fundamentally one-dimensional (Poole and Rosenthal 1991). As ideology declines in importance, councils are less likely to be decisive, which tends to increase royal control over public policy.

*Genetic shocks.* A systematic source of drift toward council and parliamentary control of policy making is variation in the talent or planning horizon of kings. Insofar as competition for membership in the council and parliament is generally more open and intense than that for king—particularly in dynasties—the talent of the council and parliament tends to be high and fairly consistent through time. In contrast, the vagaries of training and breeding imply that the talent and interests of kings tend to vary considerably through time. Less ambitious or talented kings may simply allow a relatively talented council to make more and more policy decisions directly. A weak king may be simply out-bargained by a talented council or parliament. An occasional farsighted or forceful king may not be able to fully recapture the authority given up by his weaker forebears, because of deference to tradition and precedent.

If such shocks occurred randomly, the division of power between king and council would tend to resemble a random walk. During some periods, the executive will be increasing its control over policy, during others the council or parliament will be gaining authority as political shocks change the bargaining positions of king and council and the reversion points of policy. Through time, one would expect to observe all constellations of power within a single polity, as has been the case during European history. Trends in constitutional exchange require trends in constitutionally relevant shocks.

### *Institutional Conservatism of Territorial Governments as Shock Absorption*

As monopolists, regional governments normally face far less competition for resources than most other organizations. This implies that the incentives for governments to alter their decisionmaking procedures and reward systems tend to be somewhat weaker than for most other organizations—although formateurs and their successors remain interested in reforms that improve the efficiency of their organizations insofar as this is likely to increase the expected rewards of office. The durability of regional governments also implies that more policy decisions are made by

successors 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 the organization's founders (formateurs). The reforms that regional governments adopt, consequently, tend to be relatively infrequent and relatively modest ones that advance "insider" interests, rather than great revolutionary reforms that advance the interests of "outsiders."

A territorial government's relatively great control over resources implies that its top officials are subject to fewer exogenous shocks that can only be survived by adopting major reforms. Even in cases in which reforms are literally imposed by external military events, preexisting institutions and interests are rarely ignored. Terms of surrender are usually negotiated by losing governments, and, predictably, the terms of surrender tend to reflect the interests of the officials sitting around the negotiation table. In cases in which internal military events such as a civil war or *coup de état* induce a change in government, preexisting templates for governance are normally retained, rather than revolutionized: a change of leadership takes place rather than a wholesale change of institutions. Institutional conservatism is nearly as appealing for those "taking over" existing organizations, as for those who inherit them.

Indeed, there are cases in which the purpose of a revolution is the restoration of older institutions. For example, England's medieval constitution was restored (twice) during civil wars of the seventeenth century, once after Cromwell failed to find a sustainable alternative, and once through force of arms to restore its former balance of authority, including parliament's long-standing veto power over taxes. The first is called the *Restoration* and the second is called the *Glorious Revolution*. (See chapter 12.)

## **F. Conclusions: Divisions of Authority within the King and Council Template**

A central claim of this book is that constitutional bargaining accounts for most of the reforms adopted in the eighteenth, nineteenth, and twentieth centuries that gradually produced Western democracy. Chapter 2 suggests that division of policymaking authority within organizations often begins with delegation, as various day-to-day policy decisions are delegated to team members, who in large organizations may have limited authority to make rules that bind others. Chapter 5 suggests that divided governments may also arise through constitutional bargains that increases the resources available or reduces the costs of conflict within or between organizations. Constitutional barter also may occur among insiders as interests in particular policies or the relative talent of the council and king change through time.

Historians that neglect the ebb and flow of authority within king and council systems tend to focus on the dominant part of government. They often ignore the existence of royalty after parliaments begin to dominate policymaking, and often ignore parliaments and councils when dominant kings or queens occupy the throne. Partially because of such historical narratives, neither the possibility of constitutional exchange within divided governments nor the continua of policymaking authority have received much attention in the rational choice–based political science and political economy literatures.

Indeed, even the properties of divided governments have largely been neglected. With respect to the latter, Schap (1986) and Carter and Schap (1987) demonstrate that an executive veto can affect the decisions of a legislature and policy outcomes in general. They also demonstrate that an executive veto can contribute to stability in policy choices. Persson, Roland, and Tabellini (1997) demonstrate that electoral feedback can induce a divided government to adopt policies that are more favorable to voters than would have been adopted by unified governments when candidates are not systematically different with respect to policy preferences. Dixit, Grossman, and Faruk (2000) analyze self-enforcing divisions of political or economic surplus between two parties within a democracy that interact repeatedly through time and find that stable rules for dividing a nation's resources can emerge in a divided government that is entirely self-interested, but whose relative power shifts randomly through time.

These lines of research generally assume that the division of policymaking power is exogenous for the purposes of analysis. Taking institutions as given is a reasonable assumption for short- and medium-run analysis. Institutional conservatism, as noted above, implies that most policymaking procedures tend to be stable for long periods of time, although, a few may be adjusted from time to time as external or internal conditions change.<sup>36</sup>

To entirely neglect relatively weak branches of government entirely, however, clearly understates their influence on policy, and their ability to use their limited authority to obtain additional authority in favorable circumstances. The advice of advisory councils has to be accepted now and then if serious advice is to be obtained. Administrators have to be delegated authority to be

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<sup>36</sup> Even the *Federalist Papers*, a pioneering study of divided governance, focus on a particular division of authority, without analyzing alternatives in much detail. A useful counter example that is relevant for king and council models is Dicey's (1887) overview of the manner in which the powers of royal councils ebbed in flowed during the late middle ages and early modern period.

effective, and so normally have some discretion to implement the instructions of their boards of directors, councils, or legislatures (Niskanen 1968; Breton and Wintrobe 1975).

Moreover, focusing exclusively on the polar cases of governance tends to make one forget that intermediate cases exist, and that transitions from royal to parliamentary dominance can be gradual rather than sudden. Historians that focus on the dominant branch of government tend to give readers the impression that a sudden switch occurs when a formerly weaker branch becomes dominant, rather than a slight shift of policymaking authority that led a particular historian to conclude that one or the other branch of government has become dominant. The intermediate cases provide a continuum through which gradual but substantial reforms of government policymaking procedures can take place.

In practice, some specific constitutional bargaining settings are historically more important than others. One of the most important is taken up in chapter 6, where models of the origins and effects of “the power of the purse” are developed.

## **Chapter 6: The Power of the Purse and Constitutional Reform**

The theories of governance and constitutional bargaining developed above provides a rational choice explanation for the general architecture of European governance, for peaceful reforms of parliament, and for the existence of divided governance. To more fully account for the transition to the contemporary architecture of Western Democracy, however, requires analysis of more specific aspects of governance: in particular those dealing with fiscal authority and the manner in which members of parliament are selected. This is undertaken in the next three chapters. Chapter 6 provides an explanation for the medieval power of the purse and analyzes how it can be used to obtain additional policymaking authority for parliament. Chapters 7 and 8 analyze possible reforms of election-based methods for selecting members of parliament.

Chapter 6 is a long and technical chapter. Regional governments have the ability to impose binding rules and fees (taxes) on persons throughout their territories. This—perhaps unexpectedly—provides additional economic reasons for divided governance and additional opportunities for constitutional exchange. To analyze these possibilities, the models of chapter 5 are further developed in a more mathematical form. The prose provides the intuition behind the mathematics and helps explain the results. Examples from European history are again used to motivate the analysis.

### **A. Origins of the Medieval Parliament's Limited Power of the Purse**

As a point of departure, again assume that a king-dominated form of the king and council template is in place: one-man rule with an advisory council. The council may be used as a source of information and advice, but plays no direct role in policy formation. The king can collect any taxes that he wishes and spend the money as he sees fit without taking account of the policy interests of his advisors or others outside government.

The ability to tax and spend as the king wishes creates problems analogous to those represented in tables 5.1 and 5.2, although this may not be evident at first. Territorial governments nearly always want additional tax revenue, but government cannot simply use its coercive authority to obtain additional revenues, because the size of the tax base is largely controlled by taxpayers. New tax collections may be resisted by, for example, working less hard, investing less, or exit. More militant forms of tax revolt are also possible. In such cases, allowing taxpayers some control over fiscal policy may allow additional revenues to be collected. Such constitutional bargains account for a



particular division of authority between kings and parliaments that was common in late medieval Europe. It turns out that that division of authority played a central role in the rise of Parliament-dominated governance many centuries later.

Because this division of authority is historically so important in Europe, the fiscal problem and potential gains from sharing authority over tax policies are analyzed using somewhat more general mathematical models. For purposes of analysis, assume that the king has a utility function defined over his own private consumption,  $X$ , and two government services, guns,  $G_1$ , and butter,  $G_2$ . Both the king and taxpayers benefit from both public services provided. His wealth is protected by the army and walls. He also benefits from public services such as road networks, potable water supplies, and a royal court system insofar as they enlarge the tax base and facilitate his access to useful supplies. However, only the king directly benefits from his private consumption expenditures.

$$U = u(X, G_1, G_2) \tag{6.1a}$$

The king's budget constraint is determined by his own household wealth,  $W$ , which is usually considerable; the present discounted values of the taxes that he levies,  $T$ , the cost of government services,  $C = c(G_1, G_2)$ , and his personal consumption,  $X$ . Using personal consumption as the numeraire good allows the royal budget constraint to be written as  $T + W = X + c(G_1, G_2)$ , or

$$X = T + W - c(G_1, G_2) \tag{6.2}$$

where  $c$  is a separable convex cost function of the two government services. Substituting for personal consumption yields

$$U = u(T + W - c(G_1, G_2), G_1, G_2) \tag{6.1b}$$

Differentiating with respect to the control variables  $T$ ,  $G_1$ , and  $G_2$  yields the following first-order conditions that characterize the unfettered king's preferred long-term fiscal policy:

$$U_{G_1} - U_x C_{G_1} = 0 \tag{6.3}$$

$$U_{G_2} - U_x C_{G_2} = 0 \tag{6.4}$$

$$U_x = 0 \tag{6.5}$$

The first two first-order conditions imply that the king sets public service levels so that the marginal utility of the service equals its marginal cost in terms of his diminished personal consumption of the private good. This implies that taxes will be collected until the marginal utility of his additional personal consumption falls to zero.

### *Credible Commitments and Constitutional Gains to Trade*

Unfortunately, the marginal utility of consumption reaches zero only if the king has sufficient household and tax revenue to *achieve satiety in all goods*. ( $U_x = 0$ , implies that both  $U_{G_1}$  and  $U_{G_2}$  also equal zero at the utility-maximizing public policy.) Whether this is feasible or not depends on the king's preferences and the extent to which tax revenue may be "squeezed" from the kingdom. The tax base of the kingdom is clearly constrained by the wealth of the kingdom, which in most cases derives from the productive abilities and efforts of the king's subjects as well as the country's endowment of natural resources. If the king's tastes are such that satiation does not occur within the feasible range of the kingdom's output, he will be disposed to tax away or otherwise extract the entire surplus of the kingdom. (The "surplus" is the total economic output of the kingdom above that required to retain its residents, which clearly requires at least subsistence levels of income for those producing the outputs taxed.)

Unfortunately for the king, if every subject in the kingdom expects all of their production above subsistence to be taken by the government, there is no private incentive to produce a taxable surplus and none will be produced.<sup>37</sup> To obtain the hypothetically maximal tax revenue, the king must essentially enslave the entire population of the kingdom. Exit must be blocked and a centralized system of command and control over all economic activities adopted. If neither generalized slavery nor central administration is a useful strategy—because they are inefficient, very expensive to implement, or impossible—the king's control over tax revenues will be less than absolute, even though he has complete control over tax instruments and rates.<sup>38</sup>

### *Granting Veto Power to a Council of Taxpayers*

The possibility of peaceful tax resistance is sufficient to create an opportunity for constitutional exchange between a nearly all-powerful king and those who pay the taxes.

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<sup>37</sup> This is intuitively obvious, but can easily be demonstrated. Consider a typical farmer-taxpayer whose utility is  $U = u(L, Y)$  where  $Y = (1-t)f(H-L, G_1, G_2)$ ,  $t$  is the marginal tax rate,  $f$  is a the taxpayer's strictly convex production function of farm output,  $L$  is leisure, and  $H$  is the available hours in the day.  $H-L = W$ , the hours spent farming.  $Y$  can be regarded as income greater than subsistence income. The taxpayers work  $H-L^*$  hours, and  $L^*$  is such that  $U_L - U_Y(1-t)F_W = 0$ . Note that given  $U$  monotone increasing, twice differentiable, and concave, whenever  $t = 100$  percent, a corner solution emerges with  $L^* = H$ . Subsistence output,  $Y = Y^s > 0$ , is required to survive, so leisure is  $L^* = H - f^l(Y^s)$ .

<sup>38</sup> Note that a lump-sum tax cannot be truly neutral when it is bounded by production of the taxable base and/or possibilities of exit. Farmers will produce a surplus only when the net of tax utility realized after tax is greater than that associated with subsistence and exit.

In exchange for a commitment to take only a specific fraction of the surplus, the subjects might agree to provide more tax revenue by producing more surplus. To make the promised tax system credible, the king may also promise to seek the approval of those taxed before increasing tax rates in the future. Institutionalizing veto power over new taxation makes the promise of leviathan credible. For example, veto power might be vested in a tax council that represents the interests of (major) taxpayers.

The royal advantage secured by a standing “tax council” can easily be demonstrated. In the case in which the council lacks veto power, the process of taxation can be represented as a three-stage game. In the first stage, the king announces a tax rate; in the second, the subjects produce their output; in the third, the king collects his taxes. In a one-shot game, the king would announce a very low tax in period 1, but subsequently, take the entire surplus produced in period 3 regardless of the tax announced in period 1. Forward-looking subjects would anticipate the final confiscatory tax and produce no taxable surplus. Consequently, the king’s tax revenue in period 3 would be zero in equilibrium. Constitutional gains to trade are clear. A tax institution that increases the expected after-tax income of taxpayers and produces additional revenue for the king makes each better off.

The existence of a council with veto power over tax increases transforms the three-stage into a four-stage game. In the fourth stage, the council may veto any increase in taxes announced by the king in period 3.<sup>39</sup>

In the four-stage game with a council veto over tax increases, an income-maximizing king, who is constrained to a proportional tax, will announce the proportional tax rate in period 1 that maximizes net tax receipts, given the productive propensities of his subjects. Because the revenue-maximizing tax rate is less than 100 percent, the subjects produce a surplus above subsistence, knowing that they will be able to keep a part of it, and the king collects taxes according to the announced tax schedule.<sup>40</sup>

It bears noting that *no vetoes will be observed* when the system is working smoothly; consequently, such councils may well appear to be “toothless.” Nonetheless, in the absence of the council’s veto power over new taxes, both the king and the kingdom would have been substantially poorer. The

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<sup>39</sup> Taxpayer utility always diminishes in  $t$  whenever tax receipts are increased to support additional consumption for the royal household. Given  $U = u(L, Y)$  and  $Y = (1-t)f(H-L, G_1, G_2)$ , after tax utility can be written as  $U^* = u(L^*, (1-t)f(H-L^*, G_1^*, G_2^*))$ . The envelope theorem implies that  $U^*_t = U_Y[-f(H-L^*)] < 0$ .

<sup>40</sup> The effects of alternative constraints on the royal tax base and choice of tax instruments is developed by Brennan and Buchanan (1977, 1980).

mutual advantages achieved by this constitutional reform are clear. Moreover, once enacted the king has incentives to abide by the new procedures.

The medieval tax constitution is surprisingly stable once in place because the institutional structure is (often) subgame perfect.<sup>41</sup> The king cannot formally reduce the veto power of the council without substantially undermining the tax base. For example, the king cannot simply add another stage to the game in which the king can accept or reject the council's veto. In such a game, an income-maximizing king would always be inclined to raise taxes in period 3 and then overturn the council's veto in period 5, taking the entire surplus. Production would again fall to near subsistence levels and/or mass emigration might be induced, and the taxable base would again approach zero.

Nor can the king occasionally renege on his assignment of veto power to the council by suddenly calling out the army, because his future tax receipts would tend to fall in future periods. Producers would simply discount the constitutional promise and produce less to be taxed in future periods or emigrate to other communities where constitutional promises are kept. The anticipated interventions of the army or royal tax collectors thus increase the effective rate of taxation beyond the long-term revenue maximizing rate. The taxpayer response to confiscatory taxation—reduced production or exit—is credible as long as production is a costly activity for the subjects, exit is possible, and the king is not able to reduce his subjects to abject slavery.<sup>42</sup>

### *Medieval Tax Constitutions*

It bears noting that this constitutional solution to the king's fiscal dilemma had many real-world counterparts in medieval Europe. To secure a more predictable or less costly tax revenue stream, medieval kings often created councils or parliaments composed of major taxpayers and vested those councils with veto power over new taxes. Perhaps the most famous of these formal agreements is the English *Magna Carta* of 1215, which among other provisions established a representative council of 25 barons that made decisions via majority rule and had the power to veto new royal taxes. Similar political arrangements that formally vested veto power in councils representing taxpayer

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<sup>41</sup> 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).

<sup>42</sup> I neglect many aspects of long-term continuous dealings to avoid the ambiguities of the folk theorem, which demonstrates that a wide range of equilibria are possible if one or both parties is able to make creditable commitments to particular intertemporal responses. Note, however, that the equilibria developed above are consistent with the folk theorem. For example, if the taxpayers can make a creditable commitment to reducing their taxable surplus to zero, the behavior assumed above would be equilibrium strategies in infinitely repeated games as well.

interests were also adopted in France, Spain, Germany, and Sweden at around the same time. Palmer and Colton (1965: 31) suggest that more or less similar representative institutions emerged throughout Europe during the thirteenth century as nation states emerged.

Parliaments, in this sense, sprouted up all over Europe in the thirteenth century . . . The new assemblies were called *cortes* in Spain, *diets* in Germany, Estates General in France, parliaments in the British Isles. Usually they are referred to generically as “estates,” the word “parliament” being reserved for Britain, but in origin they were essentially the same. (Palmer and Colton 1995: 34)

In most cases, the parliaments or tax councils were characterized in writing and included members that were elected via quite narrow electorates. Their electorates consisted for the most part of major tax payers. The parliaments normally had veto power over new taxation and powers to petition the king for policy reforms, as in England, Denmark, France, Spain, and Sweden. Later kings and queens often signed accession contracts (as a condition of office) in which they promised to abide by the existing constitutional rules.

These councils recognized the significance of their tax authority. During times of crisis, for example, they would tend to extend taxes only for short periods, rather than amend the tax constitution to provide new permanent sources of revenues for the king.

Medieval councils and parliaments were not merely advisory, nor was the distribution of authority between the king and council entirely static. They were amazingly durable, lasting for many centuries in most cases. Indeed, several medieval tax councils survive to the present in modified form as the parliaments of contemporary constitutional monarchies.<sup>43</sup>

## **B. Tax Veto Authority and Parliamentary Authority over Expenditures**

We next examine circumstances under which a king might voluntarily agree to cede some direct control over government programs to the council in exchange for new taxes. Such transfers of power *transform a tax council into a legislature*.

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<sup>43</sup> In most cases, the medieval European parliaments were preceded by other more or less similar forms of government. For example, grand councils, courts, and *tings* often met to advise the kings of northern Europe and to affirm new kings at times of accession.

The medieval balance of authority, did wax and wane through time as kings and queens attempted to avoid the constraints of their medieval tax constitutions. North and Weingast (1989) argue that the transfer of control over government finances from the king to the British Parliament in the Glorious Revolution made the king substantially more creditworthy. From the point of view of this chapter, the Glorious revolution is considered a case in which parliament restored its veto power over new taxes. See chapter 12.

The analysis parallels that of chapter 5, but with explicit accounting of tax-revenue constraints and mathematical representations of the equilibria. Four possible transfers of policymaking power from a strong king to a weak council are analyzed: (a) partial veto power over policy proposals, (b) complete veto power, (c) partial agenda control over policy proposals, and (d) complete agenda control. Only decisive councils are analyzed, which tends to overstate the cost of shifting legislative authority to the parliament, but allows gains and losses to be evaluated from the perspective of the pivotal member of parliament. The aim is to develop a mathematically tractable model of the market for power between the king and parliament.

Most of the conclusions turn out to be “intuitively obvious,” although the analysis demonstrates that there are many counterintuitive possibilities that need to be taken account of to reach them.

### *Constitutional Reform in Stable Political and Economic Circumstances*

Suppose that the tax constitution developed above has been adopted and the king initially retains complete authority over expenditure policies. A secure king with complete control over public policy will use “his” revenue to secure his ideal combination of public services  $G_1$  and  $G_2$ , given his veto-constrained tax revenue,  $T^0$ , and his household income,  $Y$ .<sup>44</sup> Substituting the veto-constrained tax revenue into his budget constraint, solving for personal consumption, and substituting the result into his utility function yields:

$$U = u(T^0 + Y - c(G_1, G_2), G_1, G_2) \quad (6.6)$$

which is an objective function with two control variables,  $G_1$  and  $G_2$ , and two first-order conditions similar to those above:

$$U_{G_1} - U_x C_{G_1} = 0 \quad (6.7)$$

$$U_{G_2} - U_x C_{G_2} = 0 \quad (6.8)$$

Together the first-order conditions imply that the king’s optimal policies are determined by his household income and the constraint imposed by the tax constitution:  $G_1^* = g(Y + T^0)$  and  $G_2^* = h(Y + T^0)$ . As long as the king’s personal income and the tax constitution are stable, these

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<sup>44</sup> It bears noting that tax revenue was often less important in the late medieval and early modern period than it is today. Other revenues sources normally provided more royal income than taxes per se. However, tax revenues were significant at the margin, and as demonstrated below were in the long run sufficient to produce major shifts in policymaking authority, especially in the nineteenth century when tax revenues became increasingly important sources of government revenue.

expenditure policies remain ideal as far as the king is concerned. The subjects may prefer more butter and fewer guns, or perhaps more of each with a less extravagant level of personal consumption by the king, but, under the existing institutional arrangements, they have no power to influence government services levels. They can veto new tax rates and new taxes on currently untaxed activities, but do not otherwise control the royal budget.

At this constitutionally constrained royal fiscal equilibrium, there may be additional unrealized potential gains from constitutional exchange. The council members may prefer a different combination of public services to that provided. If so, the tax council is willing to exchange higher permanent taxes in exchange for a new pattern of expenditures. It is clear, however, that the king's "agreement" is not sufficient to achieve this fiscal bargain. The king may accept a permanent increase in tax revenue from  $T^0$  to  $T^1$ , but fail to change public policies as promised. He may simply build a new wing on one of his palaces

Granting the council veto power over *public* expenditure changes does not, in this case, necessarily secure the king's promise, because there are other dimensions of royal expenditure, namely household expenditures. The king may accept the additional revenue, but use it for private consumption, rather than to increase the desired public service(s).

Insofar as no new government service levels are proposed, *the council has nothing to veto*. The same logic holds for agenda control for cases in which the king retains veto power. Here the council may propose a new pattern of expenditure, and the king may simply veto it, leaving the status quo service levels unchanged, but increasing his personal consumption. Neither veto power nor agenda control are sufficient to secure the king's promise when existing public policies are already optimal for the king, particularly in circumstances in which the king retains complete authority over other policies. Consequently, as noted in chapter 5, the king can offer veto power or even agenda control to the council in a stable political and economic setting at very low personal cost.

Such partial transfers of policymaking authority would obtain little of value from the council, however, because the council would recognize that such procedural powers would have little effect on public policies as long as political and economic circumstances are stable.

## C. The Value and Cost of Partial and Complete Veto Power in Unstable Settings

### *Vesting the Council with Partial Veto Power*

Political uncertainty increases the value of partial transfers of policymaking power to the council and the cost of such transfers for the king. Consider the case in which the king's ideal combination of government services changes from  $(G^0_1, G^0_2)$  to  $(G^K_1, G^K_2)$  and the council has secured partial veto power over changes in  $G_2$ , "butter." In this case, the king faces two constraints on his fiscal decisions, his budget constraint  $T^0 + Y - c(G_1, G_2) = C$ , and a new *procedural constraint*  $W(X^c, G_1, G_2) - W(X^c, G_1, G^0_2) \geq 0$ , where  $W$  is the utility level (welfare) of the pivotal council member, and  $X^c$  is the after-tax consumption of the decisive member of the council. Policy  $G_1$  can be set to maximize royal utility, but any new service level for  $G_2$  has to make the council better off than it would have been with the original service level  $G^0_2$ . (The superscript "0" denotes the status quo policies. The superscript K denotes the king's new ideal point.)

The council will veto any new proposed for service  $G_2$  that makes the pivotal council member worse off than he would have been at its current level  $(G^0_2)$ . The king realizes this, of course, and only proposes public policies that will satisfy the council in this sense. Policies that maximize the king's welfare, while preserving that of the council, can be characterized by differentiating the king's Kuhn-Tucker control function:

$$U = u(T^0 + Y - c(G_1, G_2), G_1, G_2) - \lambda [W(X^c, G_1, G_2) - W(X^c, G_1, G^0_2)] \quad (6.9)$$

The tangency solution(s) requires  $G_1$  and  $G_2$  such that:

$$U_{G1} - U_x C_{G1} - \lambda (W_{G1} - W^0_{G1}) = 0 \quad (6.10)$$

$$U_{G2} - U_x C_{G2} - \lambda (W_{G2}) = 0 \quad (6.11)$$

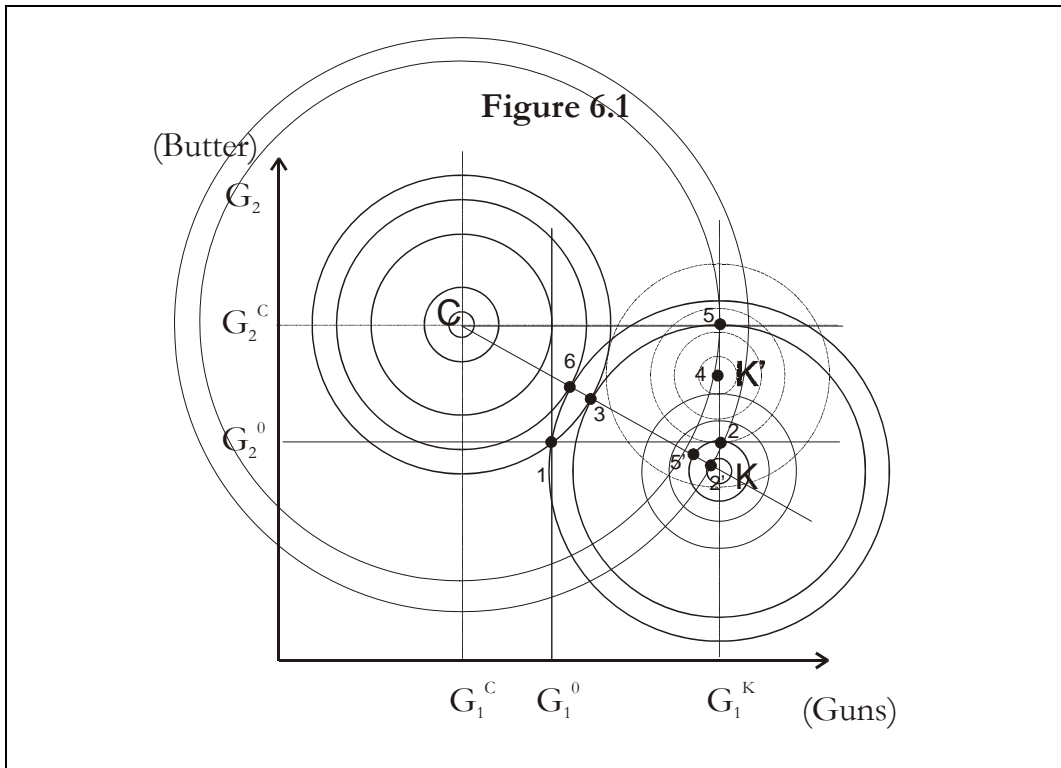
$$W(X^c, G_1, G_2) - W(X^c, G_1, G^0_2) = 0 \quad (6.12)$$

Figure 6.1 illustrates the effects of the council's veto power over  $G_2$  in the  $G_1 \times G_2$  plane. For purposes of the illustration, the pseudo-indifference curves of the king and pivotal council member are represented as concentric circles, as generally assumed in spatial voting models and in work that assumes quadratic loss functions. It is similar to the figures used in chapter 5 for the decisive council cases, but in this case the figures are used to illustrate some mathematical results, rather than being the engine of analysis. (Most of the mathematics appears in the footnotes.) The iso-utility lines are



not conventional indifference curves in that effects of changes in public policies on the king's private consumption are implicitly taken into account. (Otherwise the indifference curves could not be concentric circles, given the assumption that the public services are goods with positive marginal utilities over the range of interest.)

Given values of  $T^0$  and  $Y$ , the pivotal council member and the king have a wealth-constrained ideal policy combinations that can be represented as the highest point of their respective utility mountains in the  $G_1 \times G_2$  plane.<sup>45</sup>



Given complete control over public policy, the ideal points  $C$  and  $K$  characterize the policy combinations that the council and king would select if they had no binding procedural constraints. These points represent the policies adopted under the polar forms of the king and council constitutional template. If the king has agenda and veto power over guns and butter, he adopts the policy combination labeled  $K$ .

If in a previous period, however, the king or one of his predecessors had granted the council veto power over one of the policy dimensions, the king may not be able to adopt his ideal policy combination. The council's veto power over  $G_2$  implies that the king's new policy proposal has to

<sup>45</sup> The assumed trace of the king's utility function in the  $G_1 \times G_2$  plane is  $U = U^* - (G_1^K - G_1)^2 - (G_2^K - G_2)^2$ , and that of the council is  $U = U^* - (G_1^C - G_1)^2 - (G_2^C - G_2)^2$ .

make the pivotal member of the council at least as well off as he (or she) would have been with the status quo level of the service over which they have veto power ( $G_2^0$ ). In the case depicted, the king can only achieve policy combination 2, which is some distance from his new ideal. This policy combination is “veto proof,” because  $G_2$  remains at the status quo level, which leaves the council nothing to veto.

The mathematics of the tangency solution appears to suggest that the king can do a bit better than this by proposing a policy combination like 2', which makes the pivotal member of the council as well off as he would have been at policy 2. However, both geometric inspection and the Kuhn-Tucker first order conditions imply that 2' is not feasible. Recall that the veto player chooses last. Consequently, policy 2' would be vetoed by the council to realize a policy outcome that is a bit better than either 2' or 2 from the point of view of the council, although worse than 2' or 2 for the king. The king recognizes this and will propose policy combination 2, which is the best the king can achieve in this new political setting.<sup>46</sup>

Granting the council veto power over  $G_2$  can make the king a bit worse off in unstable settings, although this is not always the case. For example, had the king's preferred policy combination shifted to  $K'$ , rather than to  $K$ , his new ideal policy combination, 4, would have been accepted by the

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<sup>46</sup> The Kuhn-Tucker conditions for this case can be derived from the following maximand:

$$K = U^* - (G_1^K - G_1)^2 - (G_2^K - G_2)^2 - \lambda [(G_2^C - G_2^0)^2 - (G_2^C - G_2)^2]$$

where  $(G_1^C, G_2^C)$  is the ideal point of the pivotal member of the council, labeled C in figure 6.1. Differentiating with respect to  $G_1$ ,  $G_2$ , and  $\lambda$  yields the following first-order conditions:

$$-(G_1^K - G_1) \leq 0 \text{ with } G_1 \geq 0 \text{ and } G_1 [(G_1^K - G_1)] = 0$$

$$-(G_2^K - G_2) + \lambda (G_2^C - G_2) \leq 0 \text{ with } G_2 \geq 0 \text{ and } G_2 [(G_2^K - G_2) + \lambda (G_2^C - G_2)] = 0$$

$$[(G_2^C - G_2^0)^2 - (G_2^C - G_2)^2] \geq 0 \text{ with } \lambda \geq 0 \text{ and } \lambda [(G_2^C - G_2^0)^2 - (G_2^C - G_2)^2] = 0$$

The first of the first-order conditions implies that  $G_1^* = G_1^K$  or  $G_1^* = 0$ . Whether the constraint is binding or not, the king sets service level one equal to his ideal level,  $G_1^K$ , or equal to zero. The second of the first-order conditions implies that if  $\lambda = 0$ , then  $G_2^* = G_2^K$  or  $G_2^* = 0$ . If the constraint is nonbinding, either the king sets service level one equal to his ideal or equal to zero. In the case in which the constraint is binding, that is, the threat of veto affects his policy options,  $\lambda \neq 0$  and the third conditions imply that  $G_2^C = G_2$ . Consequently, there are just two equilibrium strategies for the king in this setting away from the lower bound. The king always sets  $G_1^* = G_1^K$ . If the veto power threat is not binding, he sets the veto constrained service at his ideal level,  $G_2^C$ , otherwise he sets service level 2 equal at the status quo level ( $G_2^C = G_2^0$ ).

council, because policy combination 4 is preferred by the council's pivotal member to policy combination 2, the result if  $G_2$  reverts to the status quo level. Partial veto power can interfere with a king's policymaking power, but it does not constrain him in every case, even if his preferred policy is affected by new circumstances.

### *Vesting the Council with Complete Veto Power*

As might be anticipated, the effect of granting the council veto power over both policy dimensions generally has a greater constraining effect on the king's ability to get his preferred policy than granting veto power over one dimension. Mathematically the effect of granting the council veto power over both government policies is very similar to that above. The procedural constraint under complete veto power is:  $W(X^c, G_1, G_2) - W(X^c, G_1^0, G_2^0) \geq 0$ , and the Kuhn-Tucker first-order conditions describing the best feasible policy along the constraint becomes:

$$U_{G1} - U_x C_{G1} - \lambda (W_{G1}) = 0 \tag{6.13}$$

$$U_{G2} - U_x C_{G2} - \lambda (W_{G2}) = 0 \tag{6.14}$$

$$W(X^c, G_1, G_2) - W(X^c, G_1^0, G_2^0) = 0 \tag{6.15}$$

Only the procedural constraint differs, and the constraint again may or may not be binding.

In many cases, however, granting the council veto power makes the king worse off relative to the unconstrained and partial veto power analyzed above. This possibility can also be illustrated with figure 1. Given complete veto power, the council can now reject any policy combination that makes its members worse off than the status quo ante. This implies that the king cannot choose a policy combination outside the decisive council member's iso-utility line passing through the status quo  $(G_1^0, G_2^0)$ .

If the king's new circumstances lead him to prefer policy combination  $K$ , the best that he can achieve is policy combination 3, which is inferior to policy combination 2 for the king. Policy 2 is no longer feasible. The council would now reject policy combination 2 because they prefer the original combination of services to that offered. In the case in which the council is granted complete veto power, the council now constrains the king at  $K'$ , whereas, as shown above, he would not have been

constrained by a council with partial veto power. The king will be blocked by the council's veto power in all cases in which his new ideal point lies further from the council's ideal than the status quo ante.<sup>47</sup>

A decisive council is clearly better off with complete veto power than with partial or no veto power, in such cases. They cannot be worse off. The king would thus demand a higher price for complete veto power than for partial veto power, and the council would be willing to pay a higher

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<sup>47</sup> The Kuhn-Tucker first order conditions for king in this case are derived from the following KT maximand:

$$K = U^* - (G^K_1 - G_1)^2 - (G^K_2 - G_2)^2 - \lambda[(G^C_1 - G^0_1)^2 + (G^C_2 - G^0_2)^2 - (G^C_1 - G_1)^2 - (G^C_2 - G_2)^2]$$

Differentiating with respect to  $G_1$ ,  $G_2$ , and  $\lambda$ , yields the following first-order conditions:

$$-(G^K_1 - G_1) + \lambda(G^C_1 - G_1) \leq 0 \text{ with } G_1 \geq 0 \text{ and } G_1 [(G^K_1 - G_1) + \lambda(G^C_1 - G_1)] = 0$$

$$-(G^K_2 - G_2) + \lambda(G^C_2 - G_2) \leq 0 \text{ with } G_2 \geq 0 \text{ and } G_2 [(G^K_2 - G_2) + \lambda(G^C_2 - G_2)] = 0$$

$$[(G^C_1 - G^0_1)^2 + (G^C_2 - G^0_2)^2 - (G^C_1 - G_1)^2 - (G^C_2 - G_2)^2] \geq 0$$

$$\text{with } \lambda \geq 0 \text{ and } \lambda [(G^C_1 - G^0_1)^2 + (G^C_2 - G^0_2)^2 - (G^C_1 - G_1)^2 - (G^C_2 - G_2)^2] = 0$$

The first of the first-order conditions implies that if  $\lambda = 0$ , then  $G_1^* = G^K_1$  or  $G_1^* = 0$ . If the constraint is nonbinding, either the king sets service level one equal to his ideal or equal to zero. In the case in which the constraint is binding,  $\lambda \neq 0$  and either the status quo is chosen,  $G_1 = G^0_1$  and  $G_2 = G^0_2$ , or both policies  $G_1$  and  $G_2$  lie along the indifference curve passing through the initial policy position  $(G^0_1, G^0_2)$ .

The second of the first-order conditions implies that if  $\lambda = 0$ , then  $G_2^* = G^K_2$  or  $G_2^* = 0$ . If the constraint is nonbinding, either the king sets service level one equal to his ideal or equal to zero. In the case in which the constraint is binding,  $\lambda \neq 0$  and the third constraint implies that either the status quo is chosen,  $G_2 = G^C_2$ , or both  $G_1$  and  $G_2$  lie along the indifference curve passing through the initial policy position  $(G^0_1, G^0_2)$ . There are, thus, three possible equilibrium strategies for the king in this setting according to the location of the king's new ideal point. If the veto power threat is not binding because his new ideal point is closer to the council's ideal than the original policy combination, he proposes service levels at his ideal levels  $(G^C_1, G^C_2)$ . If the procedural constraint is binding, that is, proposing his ideal point would be vetoed, the king may choose a combination of  $G_1$  and  $G_2$  such that one of his iso-utility curves is tangent to that of the Council's iso-utility line passing through the original policy combination. Alternatively, he may set both service levels at their status quo levels  $(G^0_1, G^0_2)$ .

price for complete than for partial veto power, particularly at times when the king's policy preferences are likely to change.<sup>48</sup>

## D. Partial and Complete Agenda Control

### *Granting the Council Partial Agenda Control*

Another transferable policymaking authority by which gains from constitutional exchange may be realized is agenda control. Veto power allows the empowered party to determine whether particular departures from the status quo will be undertaken. Agenda control allows the empowered party to determine which departures from the status quo can be adopted. As in the case of veto power, the value of agenda control to the council depends on future changes in the king's policy preferences, as noted above. Without changes in his policy preferences, the king can costlessly give agenda control to the council and defend the status quo by vetoing all proposed changes.

We next analyze the extent to which a partial transfer of agenda control constrains a king's future policies.

Given partial agenda control, the council will make the specific proposals that maximize its own welfare given the king's veto power. Given agenda control over  $G_2$ , the pivotal member of the council will propose a level of  $G_2$  that maximize his or her utility given the veto power of the king and the king's choice of  $G_1$ .

$$W = w(X^c, G_1, G_2) - \lambda [u(T^0 + Y - c(G_1, G_2), G_1, G_2) - u(T^0 + Y - c(G_1, G_2^0), G_1, G_2^0)] \quad (6.16)$$

The Kuhn-Tucker tangency solution requires:

$$W_{G_2} - \lambda [U_X(-C_{G_2}) + U_{G_2}] = 0 \quad (6.17)$$

while the king sets the policy that he fully controls,  $G_1$ , to maximize:

$$U = u(T^0 + Y - c(G_1, G_2), G_1, G_2) \quad (6.18)$$

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<sup>48</sup> Veto power is occasionally shared, as in the settings with multiple veto players analyzed by Tsebelis (2002), although this possibility is neglected in the present analysis. If veto power were the only policymaking authority available, such divisions would often lead to stalemates and worse in "zero sum" settings, as implied by Hobbes' (1651) analysis of divided sovereignty, and would more often produce conflict than opportunities for constitutional reform. Buchanan and Yoon (2000) discuss the problem of multiple veto powers in their piece on the "anti-commons." Tsebelis notes that fully rational participants in a government with multiple veto players will take the interests of other veto players into account to avoid complete deadlocks.

which requires:

$$U_{G1} - U_X C_{G1} = 0 \tag{6.19}$$

given  $G_2$ . Policy combinations that satisfy both first-order conditions simultaneously are analogous to Nash equilibria in noncooperative games.

The geometry of granting partial agenda control to a noncooperative council can be illustrated with figure 6.1. Were it not for the veto power of the king, the Nash solution to this policymaking game would resemble policy combination 5 in figure 6.1, in which the king and the council secure their preferred level of the service over which they exercise agenda control. Given complete veto power, however, the king can do better than policy combination 5 by vetoing the council's proposed level of "butter." The result in this case is policy combination 2, which combines the king's ideal level of "guns" with the status quo level of "butter." The vetoer goes last in full knowledge of the proposal of the agenda setter.

Anticipating this, the council might be tempted to moderate its proposal for "butter" service levels, but no proposal that it makes above  $G_2^0$  would be accepted by the king, and no service level below  $G_2^0$  would lead to a better policy combination for the council than that of 2 because the king can keep  $G_1$  at his preferred level (under the assumed geometry, this is a dominant strategy). In this case, granting agenda control to the council leads to the same policy as a grant of partial veto power to the council.<sup>49</sup>

This equivalence, however, is an artifact of the particular preference shift of the king. Had the king's ideal point shifted to  $K'$ , policy combination 5 would have been veto proof and agenda control would have made the council better off than partial veto power.<sup>50</sup> Policy combination 2 is a

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<sup>49</sup> Again, gains to fiscal exchange exist at policy combination 2; however, in this case, the agenda setter cannot capture these potential gains to trade. If the council suggests the "butter" service level required for policy 5', the king would accept this, but still opt for his preferred level of "guns." Under the procedural institutions in place, the gains from fiscal exchange would be unrealized.

<sup>50</sup> The Kuhn-Tucker conditions for the council are derived from the following KT maximand:

$$K = W^* - (G^C_1 - G_1)^2 - (G^C_2 - G_2)^2 - \lambda[(G^K_2 - G^0_2)^2 - (G^K_2 - G_2)^2]$$

Differentiating with respect to  $G_2$ , and  $\lambda$ , yields the following first-order conditions:

$$-(G^C_2 - G_2) + \lambda(G^K_2 - G_2) \leq 0 \text{ with } G_2 \geq 0 \text{ and } G_2 [(G^C_2 - G_2) + \lambda(G^K_2 - G_2)] = 0$$

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possible outcome under both institutions, but policy combination 4 is preferred by the king to policy combination 5. The pivotal council member, however, prefers policy combination 5 to policy combination 4. This suggests that king is somewhat worse off and the council is somewhat better off with partial agenda control than with partial veto power.

### *Vesting the Council with Complete Agenda Control*

Granting complete agenda control to the council, while keeping complete veto power, makes the king worse off than granting complete veto power to the council. Given complete agenda control, the council would propose a policy combination that maximizes:

$$W = w(X^c, G_1, G_2) - \lambda[u(T^0+Y - c(G_1, G_2), G_1, G_2) - u(T^0+Y - c(G_1^0, G_2^0), G_1^0, G_2^0)] \quad (6.20)$$

The Kuhn-Tucker tangency solution for which requires:

$$W_{G_2} - \lambda [U_X(-C_{G_2}) + U_{G_2}] = 0 \quad (6.21)$$

$$W_{G_1} - \lambda [U_X(-C_{G_1}) + U_{G_1}] = 0 \quad (6.22)$$

$$[(G_2^K - G_2^0)^2 - (G_2^K - G_2)^2] \geq 0 \text{ with } \lambda \geq 0 \text{ and } \lambda [(G_2^K - G_2^0)^2 - (G_2^K - G_2)^2] = 0$$

The first of the first-order conditions implies that if  $\lambda = 0$ , then  $G_2^* = G_2^C$  or  $G_2^* = 0$ . If the constraint is nonbinding, the council sets service level two equal to its ideal level (or equal to zero if that is less than or equal to zero). In the case in which the constraint is binding,  $\lambda \neq 0$ , the second constraint implies that the status quo is chosen,  $G_2 = G_2^0$ .

The king's optimization problem is unconstrained for service level one and constrained by the agenda chosen by the council in stage one, which he can choose to veto or not. He chooses  $G_1$  to maximize:

$$K = U^* - (G_1^K - G_1)^2 - (G_2^K - G_2)^2$$

which requires:

$$-(G_1^K - G_1) = 0 \text{ or } G_1^K = G_1.$$

The king sets service level one at his ideal level regardless of what the Council chooses for service level 2. There are, thus, two possible equilibrium budgets in this setting according to the location of the king's new ideal point. If the king's veto power threat is not binding, the council's proposes its own ideal service level for  $G_2$ ,  $G_2^* = G_2^C$ . If the king's veto power is binding, the council proposes the status quo level of service two is proposed,  $G_2^* = G_2^0$ . The separability of spatial utility functions implies that the king always chooses his ideal level of service 1,  $G_1^K = G_1$ , and, given the above option, never veto's the council's proposal.

At the tangency solution, the council chooses its utility-maximizing combination of guns and butter along the king's iso-utility line passing through the initial policy combination. Figure 6.1 illustrates the geometry of this solution with policy combination 6. Policy combination 6 is the most favorable of the policies examined for the council and the least favorable to the king. It is essentially the mirror image of the case in which the king had agenda control and the council veto power.

Given complete agenda control, *nearly all changes in the king's policy preferences make the pivotal member of council better off*. Moreover, the council can now assure the status quo ante; so, changes in the king's preferences can no longer make the pivotal member of the council worse off. There are three possible equilibrium strategies for the council in this setting according to the location of the king's new ideal point. If the king's veto power threat is not binding, because his new ideal point is closer to the council's ideal than the original policy combination, the council proposes service levels at the pivotal member's ideal point  $(G^C_1, G^C_2)$ . If the procedural constraint is binding and away from the lower bound  $(0, 0)$ , the council may choose a combination of  $G_1$  and  $G_2$  such that the pivotal member's iso-utility curves is tangent to the king's iso-utility line passing through the original policy combination. Alternatively the council may set both service levels at their status quo levels  $(G^0_1, G^0_2)$ .<sup>51</sup>

<sup>51</sup> The Kuhn-Tucker conditions for council in this case are derived from the following KT maximand:

$$W = W^* - (G^C_1 - G_1)^2 - (G^C_2 - G_2)^2 - \lambda[(G^K_1 - G^0_1)^2 + (G^K_2 - G^0_2)^2 - (G^K_1 - G_1)^2 - (G^K_2 - G_2)^2]$$

Differentiating with respect to  $G_1$ ,  $G_2$ , and  $\lambda$  yields the following first-order conditions:

$$-(G^C_1 - G_1) + \lambda(G^K_1 - G_1) \leq 0 \text{ with } G_1 \geq 0 \text{ and } G_1 [-(G^C_1 - G_1) + \lambda(G^K_1 - G_1)] = 0$$

$$-(G^C_2 - G_2) + \lambda(G^K_2 - G_2) \leq 0 \text{ with } G_2 \geq 0 \text{ and } G_2 [-(G^C_2 - G_2) + \lambda(G^K_2 - G_2)] = 0$$

$$[(G^K_1 - G^0_1)^2 + (G^K_2 - G^0_2)^2 - (G^K_1 - G_1)^2 - (G^K_2 - G_2)^2] \geq 0$$

$$\text{with } \lambda \geq 0 \text{ and } \lambda [(G^K_1 - G^0_1)^2 + (G^K_2 - G^0_2)^2 - (G^K_1 - G_1)^2 - (G^K_2 - G_2)^2] = 0$$

The first of the first-order conditions imply that if  $\lambda = 0$ , then  $G_1^* = G^C_1$  or  $G_1^* = 0$ . If the constraint is nonbinding, either the council sets service level one equal to its ideal or equal to zero. In the case in which the constraint is binding,  $\lambda \neq 0$  and the procedural constraint implies that either the status quo is chosen,  $G_1 = G^0_1$  and  $G_2 = G^0_2$ , or both  $G_1$  and  $G_2$  lie along the indifference curve passing through the initial policy position  $(G^0_1, G^0_2)$ .

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## **E. Public Policy Opportunity Sets with Divided Authority**

The mathematical analysis demonstrates that the range of policies that are feasible for the king varies with the division of policymaking powers. Overall, it is clear that more favorable policy outcomes are often obtained by the council in unstable settings as policymaking authority is transferred to it. However, the results do not produce a simple deterministic ranking of divisions of authority. Figure 6.2A and 6.2B illustrate the typical “policy opportunity sets” for the king under different power-sharing arrangements. Figure 6.2A illustrates the feasible set for complete and partial assignments of veto power to the committee. Figure 6.2B depicts the feasible sets of policy outcomes for complete and partial agenda control. Together these figures allow the restrictiveness of the four assignments of policymaking power to be compared. The feasible sets are not convex and the relationships of the feasible policy domains to one another are not immediately obvious.

Figure 6.2A depicts the range of policies that can be adopted under alternative assumptions about the council veto power. In the case of complete veto power, the council can block any move that will make it worse off than the status quo ante (labeled policy combination 1). The range of possible policy outcomes under complete veto power consists of those policy combinations that lie inside the decisive council member’s indifference curve through the status quo policy. This is the shaded circular area in figure 6.2A.

In the case of partial veto power, the council will also accept all such policies, but cannot block some policies that make it worse off. The council will veto any policy proposal made by the king in which the status quo level of the service over which it exercises veto power is preferred to that of the policy proposed by the king. For the spatial preference ordering assumed for the diagrams, this implies that only policies within the trapezoid are potentially acceptable. (The budget constraint of the king determines the upper bound of the trapezoid in the uncontrolled dimension.)

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Similarly, the second of the first-order conditions implies that if  $\lambda = 0$ , then  $G_2^* = G_2^C$  or  $G_2^* = 0$ . If the constraint is nonbinding, either the council sets service level one equal to its ideal or equal to zero. In the case in which the constraint is binding,  $\lambda \neq 0$  and the third constraint implies that either the status quo is chosen,  $G_2 = G_2^C$ , or both  $G_1$  and  $G_2$  lie along the indifference curve passing through the initial policy position  $(G_1^0, G_2^0)$ .

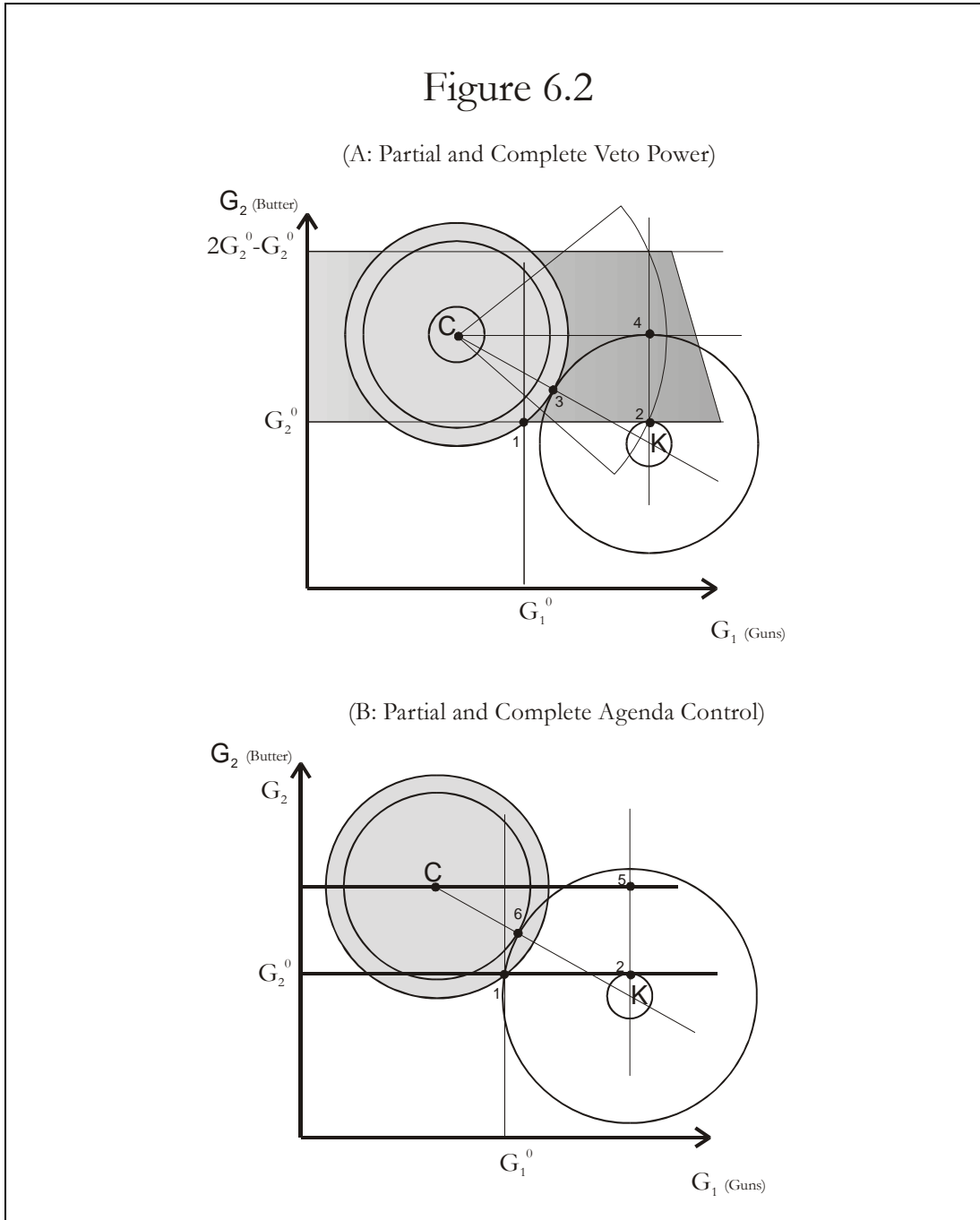


Figure 6.2B depicts the range of policies that may be chosen when council has various degrees of agenda control. In the case of complete agenda control, the council will only propose policies that make it better off relative to the status quo ante. (If no better alternatives are veto proof, the council proposes the status quo ante.) Consequently, the range of possible proposals is limited to those within the council's indifference curve passing through the initial policy position. For the spatial

preferences used in our illustrations, the feasible set is a circular shaded area similar to that shaded in figure 6.2A.

The feasible policies under partial agenda control include that area plus other policy combinations that may emerge from the king's area of control given the council's proposals for the policy over which it exercises agenda control. The geometric and mathematical results above imply that the council will either propose its own ideal service level or the service level of the status quo. Consequently, the range of policy outcomes that can arise under partial agenda control include the circular area associated with complete agenda control plus additional two line segments. The upper bound of the line segments in the uncontrolled dimension ( $G_1$ ) is determined by the king's budget constraint.

The more restrictive the procedural constraints, the smaller average distances to the council's ideal point tend to be and the larger they tend to be for kings.

## **F. The Demand and Supply of Policymaking Authority**

We now characterize the willingness of the council or parliament to pay for additional control over public policy and the reservation price that the king or president requires for "selling" policymaking power.

The reservation price for the king to shift policymaking power to the council and the reservation value to the council for shifts of power to the king can be assessed given a probability density function that describes likely shifts in the king's preferences (or political circumstances) and the associated effects of alternative distributions of legislative authority on public policies. For example, if all the possible policy outcomes are considered to be equally likely in the long run, the council's reservation offer is least for partial veto power, followed by partial agenda control, then by complete veto power, and thereafter by complete agenda control. The king's reservation prices have the opposite rank order; the least binding will be offered at the lowest price in terms of new tax revenues (or other transfers from the council to the king). The marginal reductions in the feasible domain of policy become smaller as the legislative authority is shifted to the council, which suggests that the marginal cost of ceding additional powers to the parliament declines.

Let  $j(G_1, G_2)$  be the probability function that describes the range of policies that the king may wish to pursue if not constrained and  $k(G_1, G_2, R_i)$  the probability function describing the range of policies that the king may wish to pursue under procedural restraint  $R_i$ . The domain of  $k$  is a subset of that of  $j$ .

The lowest offer that the king would accept to adopt  $R_i$  is  $O^{k*}$  such that:

$$\int \int j(G_1, G_2) u( T^0 + Y^k - c(G_1^{**}, G_2^{**}), G_1^{**}, G_2^{**}) dG_1 dG_2 -$$

$$\int \int k(G_1, G_2, R_i) u( T^0 + O^{k*} + Y^k - c(G_1^*, G_2^*), G_1^*, G_2^*) dG_1 dG_2 = 0 \quad (6.24)$$

Similarly, the highest offer that the council would be willing to make would be:

$$\int \int j(G_1, G_2) w( Y^c - T^0 - c(G_1^{**}, G_2^{**}), G_1^{**}, G_2^{**}) dG_1 dG_2 -$$

$$\int \int k(G_1, G_2, R_i) w( Y^c - T^0 - O^{c*} - c(G_1^*, G_2^*), G_1^*, G_2^*) dG_1 dG_2 = 0 \quad (6.25)$$

where policies are set at the king's ideal for the cases of interest, as developed above.

For bounded and continuous probability and utility functions, the implicit function theorem applied to equation 6.24 implies that lowest offer that the king will be willing to accept can be written as:

$$O^{k*} = s( R_i, T^0 + Y^k ) \quad (6.26)$$

and, from equation 6.25, the highest that the council is willing to be make as:

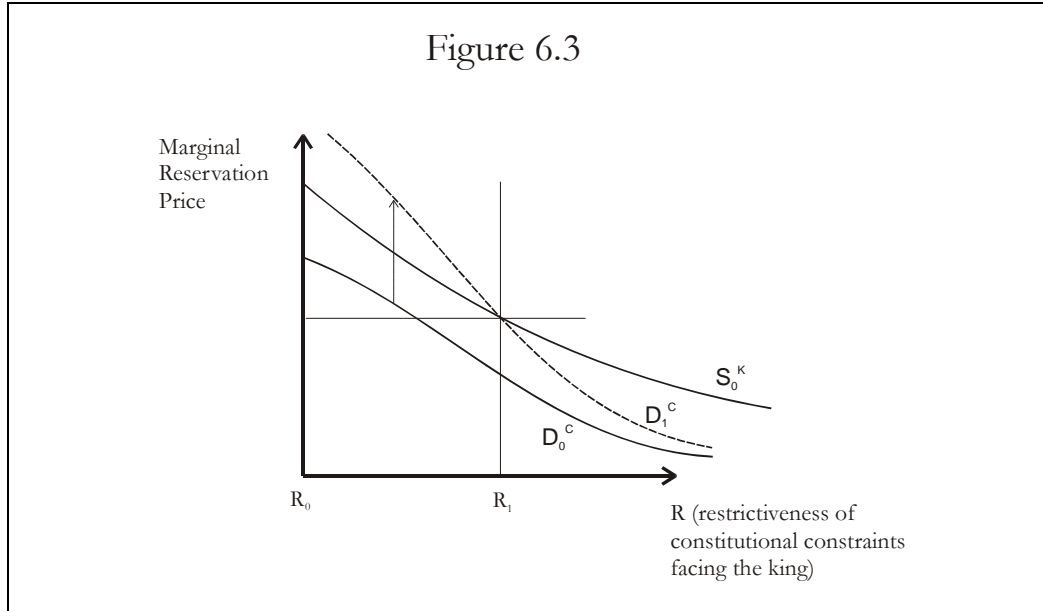
$$O^{c*} = d( R_i, T^0 + Y^c ) \quad (6.27)$$

As in ordinary markets the *exchange occurs when the reservation price of the party demanding more power exceeds that of the party that currently possesses the authority of interest*. For a wide range of probability functions, it is clear that the rank order of these prices will parallel the restrictiveness of the procedural constraints.

In polar cases, there may be no intersection of the demand and supply of authority curves, because the reservation price for transfers of power is too great for the other to pay. This case is illustrated in figure 6.3 for king dominated systems with curves  $D_0^C$  and  $S_0^K$ . In intermediate distribution of authority, as with  $D_1^C$  and  $S_0^K$ , the two curves intersect, and small shifts in supply or demand will produce gains to trade. In such cases, constitutional bargains that shift authority to the parliament may be reached by trading a broader tax base, or other in-kind services, to the king in exchange for greater policymaking authority. The reverse occurs when the kings purchases additional authority from the parliament.

For constitutional bargaining between the king and council to be mutually beneficial, in king dominated or council dominated systems there must be a fairly large shock of some kind to produce new gains to trade. For example, there may be a crisis that affects only one of the parties. For

example, the king may have urgent financial needs, because of poor investments in royal enterprises or may face a new unusually threat of piracy. In intermediate case, any shocks sufficient to overcome institutional conservatism may generate new gains to constitutional exchange.



Gains to trade may arise, for example, when there are changes in untaxed wealth or royal income. A decline in the king's wealth causes his reservation price for authority to fall.

$$O^{k*}_{Yk} = [ \iint j(G_1, G_2) u_{Yk} - k(G_1, G_2, R_i) u_{Yk} dG_1 dG_2 ] / - [ U^e_{oo} ] < 0 \quad (6.28)$$

An increase in the council's wealth causes its reservation price for political power to increase.

$$O^{c*}_{Yc} = [ \iint j(G_1, G_2) w_{Yc} - k(G_1, G_2, R_i) w_{Yc} dG_1 dG_2 ] / - [ W^e_{oo} ] > 0 \quad (6.29)$$

Constitutional exchange takes place when  $O^{c*} > O^{k*}$ .

The shift from  $D_0^C$  to  $D_1^C$  in figure 6.3 illustrates how a change in demand for policymaking power can lead to a partial transfer of power from the king to the council. A sufficient increase in the reservation price of the council can make it willing to purchase additional policymaking power from the king, and as illustrated, the king may be willing to sell it. In the illustration, authority  $R_1$  is transferred to the council, perhaps partial veto power over domestic spending. Within the context of

the model, such exchanges may involve amendment of the tax constitution. During a crisis, shifts of authority may be temporary, as for example, new temporary veto powers may be exchanged for a temporary increases in tax revenues.<sup>52</sup>

The king may also occasionally “buy back” some or all of the council’s constitutional powers, in cases in which his wealth increases relative to that of the council. Even in peaceful and lawful political circumstances, the road to parliamentary democracy is not a one-way street, nor one that always leads to full parliamentary rule.

In the absence of systematic trends favoring one or the other center of policymaking authority, a random walk of power-sharing arrangements between king and council may arise as weather, disease, and technology change through time, with periods during which the council increases its power and others during which the king becomes less subject to council vetoes and agenda control.

### *Purchasing Power: Taxes for Policymaking Authority*

Among the systematic trends that have been observed in rapidly industrializing countries are those affecting the extent and distribution of wealth. Consider the effect of taxpayer income or wealth on the level of taxation allowed by a the tax constitution. Suppose that the pivotal member of a decisive council knows the king’s objective function, is assured of veto power over taxes, and knows his or her tax payments. The council thus knows that public services are set at  $G^1* = g(Y + T^0)$  and  $G^2* = h(Y + T^0)$  by the king under tax limitation  $T^0$ .

The pivotal member’s ideal fiscal package, given the King’s supply functions, would adjust the royal budget,  $T$ , to maximize:

$$U = u[Y^{C0} - s(T), g(Y + T), h(Y + T)] \quad (6.30)$$

where  $s(T)$  is pivotal voter’s share of the tax revenues paid. This requires:

$$- U_x s_T + U_{G1} g_T + U_{G2} h_T = 0 \quad (6.31)$$

This ideal tax may exceed the that allowed by the current, in which case, there are potential gains to trade, at least from the council’s perspective. The ideal tax system provides revenues:

$$T^* = t(Y^{C0}) \quad (6.32)$$

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<sup>52</sup> Constitutional exchange involving councils that represent other interests, for example, religious or ideological ones may also engage in constitutional exchange. In such cases, the terms of trade may include metaphysical dimensions as well as tangible ones. For example, a religious council or chamber of parliament may exchange theological support for the king for tax exemptions.

and the pivotal council members welfare is:

$$U^* = u[Y^{C0} - s(T^*), g(Y + T^*), h(Y + T^*)] \quad (6.33)$$

Whenever  $T^* > T^0$ , it can be said that parliament (the council) is willing to fund additional services and/or to pay for additional public policymaking authority. Equation 6.32 implies that this willingness to pay is affected by a subsequent increase in the wealth of the groups represented in parliament. It is clear that as parliament's income increases, the willingness to trade tax expansions for service increases and/or additional policymaking authority increases:

$$T^*_{Yc} = [-W_{XXST} - W_{CSST}] / -[W_{TT}] > 0 \quad (6.34)$$

Given  $W$  concave and  $s_T > 0$  and  $s_{TT} \geq 0$ . The king's own welfare also increases with tax revenue:

$$U^*_{Tc} = U_X + U_{G1} g_T + U_{G2} h_T > 0. \quad (6.35)$$

Consequently, a sufficiently large increase in the wealth of those represented in parliament can produce constitutional exchanges in which the tax constitution is revised in exchange for policy making authority.

Parliaments are also willing to pay more taxes to secure additional control over public policy, whenever uncertainty about the king's future policy agenda increases, because political insurance clearly becomes more valuable in such circumstances. This suggests that constitutional bargains will be more likely to be consummated towards the end of a king's life (term of office) or at the beginning of a new king's term. This insurance demand for authority is also affected by cultural and technological shifts that undermine traditional patterns of life.

### *Parliamentary Authority Does Not Imply Democracy*

Insofar as parliaments represent more interests than the king tends to, trends in constitutional exchange that favor parliamentary authority may be said to favor democracy, as often argued by economists and political scientists.<sup>53</sup> It bears noting, however, that parliamentary authority and the basis for membership in parliament are controlled by different laws and that the procedures for adjusting the balance of authority between the king and parliament are different from those for changing the basis of membership in parliament.

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<sup>53</sup> In this sense, political liberalization and economic development are predicted to be correlated, as found in Paldam and Gundlach's (2008) analysis of contemporary transition data.

Parliaments thus can gain authority without changing the basis for membership in its chambers. England and Sweden, for example, had periods of parliamentary rule in the seventeenth and eighteenth centuries, respectively. In neither case was there a major expansion of suffrage, although in the English case there were experiments with changing the basis for membership in parliament. Given the medieval qualifications for membership in parliament—nobility and wealth—it may be said that the rise of parliament tends to replace autocracy with aristocracy.

Moreover, there is nothing about king and council governance, per se, that implies that the rise of parliament is inevitable or irreversible. Gains to trade between a parliament and a king or prime minister can also shift power from parliament to the executive during times of domestic or international crisis.<sup>54</sup> Parliaments may, for example, expect that the executive's better information about the problems will lead to policies that better advance broad national interests during military or economic crises. Such reforms are often intended to be temporary, but not always so.<sup>55</sup>

### *Stability of the Medieval Division of Authority*

Before 1800, periods of parliamentary control over public tended to be relatively brief, because there was a tendency to return to the medieval balance of authority. Charles II was invited by parliament to restore England's medieval constitution a year after Cromwell's death in 1658. The eighteenth century "Age of Liberty" in Sweden was ended by Gustav III in 1772, partly through decisions of the Swedish Riksdag in response to a fiscal crisis. The Dutch republic had seen the rise of executive power in the eighteenth century as the office of stadhouder became an increasingly

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<sup>54</sup> Other possibilities also exist, of course. For example, Wintrobe (1998, ch. 11) develops a theory of the emergence of dictatorship as a consequence of democratic inaction. Kuran (1989) demonstrates how public opinion can rapidly switch from one preferred policy or form of political organization to another as a consequence of differences between public and private preferences generated by conformitive pressures. Mommsen (1995: 11–14), among others, suggests that the German Constitution of 1871 was adopted by Bismarck in large part to counter liberal and socialist lobbying groups that emerged in rapidly industrializing Germany.

<sup>55</sup> In some such settings, there may be a tendency to shift from one extreme to the other. In correspondence, George Tridimas notes that if the constitutional supply curve is 'flatter' than the demand curve in figure 6.3, the equilibrium (intersection point) is unstable in the sense that a series of myopic disequilibrium price adjustments is unlikely to converge to the equilibrium price. In such cases, an ever increasing (or decreasing) sequence of political bargains may continue until we hit the vertical (or horizontal) axis. The latter suggests that one of the two decisionmaking bodies tends to become all powerful. However, insofar as the supply curve is 'steeper' than the demand, as drawn, the equilibrium is stable. Small adjustments in the terms of constitutional trade move the constitution (assignment of policymaking authority) back toward the equilibrium levels characterized by the intersection of demand and supply in figure 6.3.



regal post. In the second half of the eighteenth century, George III began reclaiming powers from the British parliament, before being overtaken by health problems. The French Revolution of the late eighteenth century was reversed after the defeat of Napoleon, and a hereditary French sovereign was restored by the Congress of Vienna in 1815.

The long-run medieval equilibrium of king-dominated “king and council” systems of governance must have seemed as safe and sound as ever in 1815, except perhaps in the recently formed United States of America. And even there, the shift from the first U.S. constitution, the *Articles of Confederation*, to the modern one can be interpreted as a peaceful shift of power from a council-dominated system—the Congress—to a mixed system with greater executive authority—the new constitution created the office of president and vested it with substantial powers. (For more on these historical cases, see the historical narratives of part II.)

Yet in just slightly over a century, the long-standing king-dominated systems of governance disappeared throughout Europe. Parliaments rose in legislative and fiscal authority, and their members came to be chosen by increasingly broad electorates. Ancient tax systems based on land and tariffs were replaced with new ones based on income and manufacturing. Ancient economic systems based on monopoly privileges, family, and farming were replaced with far more open systems based on large scale commercial and manufacturing enterprises. Ancient legal and political systems based on birth, status, and/or wealth were replaced by more uniform bodies of law that applied equally to all adult men and women.

The last two chapters can account for the increase in parliamentary authority and for the “modernization” of taxation. For example, data for Great Britain assembled by Lindert (1986, table 1) indicates that the value of noble estates averaged 2032£ in 1810 and had risen to 9,855£ in 1875. Merchant estates averaged far less, 608£, in 1810, but by 1875 had risen to 11,804£, both in constant 1875 British pounds sterling. Other classes/occupations also had significant increases in wealth, although not as great as those of merchants or “titled persons.” The population of nobles was essentially stable between 1810 and 1875 (rising from 22,000 to 25,000), whereas that of merchants, professionals, and industrial and building trades increased substantially (rising from 42,000 to 61,000 and from 638,000 to 2,835,000 respectively). Overall, the fraction of wealth controlled by those *outside the nobility* clearly increased substantially during the nineteenth century. It seems clear that increases in nonroyal relative to royal wealth would create new opportunities for constitutional exchange in the nineteenth century favoring parliament.

During the eighteenth and nineteenth centuries, new liberal political and economic ideologies also tended to make parliament more decisive and less satisfied with the status quo, while the power of the purse allowed it to trade tax revenue and increase royal allowances for increased policymaking authority. Royal demands for revenues increased as the cost of competitive navies, armies, and palaces increased while revenues from tariffs declined. Ideological shifts (the rise of liberalism) also tended to increase resistance to arbitrary authority inside and outside government, which further increased the bargaining power of parliament and somewhat reduced that of the king. All these changes favored constitutional reforms that shifted political authority from kings to their parliaments.

To transform the medieval king and council template into a liberal parliamentary democracy also required another series of reforms, one that broadens the electoral base used to select members of parliament and increased competition for those offices. In practice the reforms of parliament and suffrage were not usually adopted simultaneously, which suggests that these important series of reforms were caused by somewhat different factors. Nineteenth century history thus suggests that a separate analysis of suffrage reform is necessary.

## **Chapter 7: Suffrage without Democracy**

Before the nineteenth century, medieval parliaments represented the interests of major landholders: the church, nobility, and relatively wealthy merchants and farmers. Those sitting in parliament gained their seats through a mixture of hereditary, appointments, and elections based on narrow suffrage. The subset of the members that were elected to their offices often ran unopposed and represented, for the most part, locally powerful families. Those eligible to run for office often had to be relatively wealthy men, both as a formal condition of eligibility, and in order to be able to afford to attend meetings of parliament, members of which were not directly paid for their services. There were no professional members of parliament, per se, although members with jobs in the capital city often invested considerable time and energy in parliamentary activities. Those eligible to vote in elections varied among localities, but suffrage for the wealthiest 5–10 percent of taxpayers was fairly common. Elections for office were normally public through physical divisions (all those in favor of “x” stand over there) or by voice vote. Literacy was not extensive in the early days of parliament and both paper and printing were expensive.

Parliaments, themselves, met irregularly and only for relatively short periods. Not all members would attend the meetings called, because travel was difficult in those days and the issues were not always important, although in some cases proxy (weighted) voting was allowed for those not able to attend. Many members of parliament earned their living through positions in the national bureaucracy or local governments, or were simply employees of large estates or commercial firms. Kings would sensibly appoint persons who generally voted the “correct” way to the national bureaucracy and to their advisory councils. This allowed kings to know what parliaments were up to and to influence a significant block of votes that would reliably attend the meetings of parliament. As a consequence, the men elected to the “commoner chambers” often represented noble or royal interests, although the majority did not hold noble title.<sup>56</sup>

Such dynastic political systems tend to reduce political competition, which in some settings can promote economic development by reducing wasteful forms of political conflict, as noted above. The economic regulations that the medieval parliaments adopted (or accepted) also tended to reduce economic competition through various land and market privileges, and through restrictions on labor

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<sup>56</sup> Local governments often had a more representative structure than national governments. City-states were often republics ruled by narrowly elected councils, rather than formally hereditary rulers. Farm villages often made local policy decisions at broadly attended town meetings.

mobility. These restrictions created economic property rights that were quite different from contemporary Western property law, at the same time that they tended to create substantial economic and civic inequality. Indeed, history suggest that the privileges and legal practices evolved to support royal and noble authority and to protect the economic rents of local elites in a manner consistent with the theory of regional governance developed in the first chapters of part I.

The next two chapters analyze possible rational choice–based explanations for changes in the procedures through which members of parliament are chosen. Chapter 7 helps to explain why medieval parliaments in which a significant number of members were elected did not automatically produce democratic rule. Neither rising income nor popular revolution are likely to be the main explanation for the lawful and gradual expansion of suffrage, even when suffrage law is entirely controlled by elected members of parliament. Chapter 8 provides an indirect explanations for suffrage reform based on shifts in ideological and economic interests.

### **A. A Narrowly Elected Parliament's Disinterest in Electoral Reform**

Given the medieval composition of parliaments, including their house(s) of commons, a natural point of departure for analysis of suffrage reform is one in which the privilege of voting for representatives is defined by wealth or income. In most cases, parliaments were free to organize themselves without direction from the king (although not necessarily without royal interest or influence), and so royal support or opposition to electoral reform can be neglected in order to focus on parliamentary incentives for electoral reform. The stability of medieval political-economic systems suggests that parliamentary systems are not necessarily destined to evolve from aristocratic regimes into parliamentary democracies.

It is important to note that a general disinterest in suffrage reform within parliament does not require royal veto threats, inordinate noble or royal control over parliament, or extreme institutional conservatism, although these may also counter any impulse for suffrage reform that emerges. It turns out that both the pivotal voter and the pivotal member of parliament are very likely to be completely satisfied with the existing suffrage laws, if they have only pragmatic policy interests. To see this, we need to analyze the kinds of policies that a narrowly elected parliament would favor; and given those policies, what preferences for suffrage laws look like at the level of the pivotal or median voter.

### Voter Demands for Government Services

Consider the following highly simplified model of parliamentary decisionmaking under preexisting suffrage laws in a setting otherwise lacking medieval features. Suppose that citizens have preferences defined over private consumption,  $X_i$ , and a bundle of public services,  $G_i$ , that are uniformly available to all within the community,  $U_i = u(X_i, G_i)$ . Each citizen has an endowment of labor,  $L_i$ , and capital,  $K_i$ . National income  $Y$  is produced via constant returns to scale using labor and capital under technology  $Z$ . This implies that national income can be represented as  $Y = f(\sum L_i, \sum K_i, Z)$ . In cases, in which markets are competitive, each person would receive his or her marginal product, with wage rate,  $w = df/dL$ , and return on capital,  $r = df/dK$ . In less competitive settings, wages would differ from marginal product. In either case and citizen  $i$ 's income can be represented as  $Y_i = wL_i + rK_i$ , and  $Y = \sum Y_i$ .

Let  $C = c(G, Z)$  be the rate of transformation between private consumption good  $X$  and government service  $G$ . This implies that private consumption,  $X$ , can be characterized as  $X = Y - c(G)$ . Assume that government services are funded with a proportional tax on income just sufficient to fund the service level demanded,  $tY = C(G_i)$ . In this case, the citizen-voter will prefer the service level that maximizes:

$$U = u( (1 - C(G_i, Z)/Y) Y_i, G_i ) \quad (7.1)$$

which requires service level  $G_i$  to be such that:

$$u_x( (1 - C_G / Y) Y_i + u_G = 0 \quad (7.2)$$

The implicit function theorem implies that the typical citizen's demand for government services is determined by:

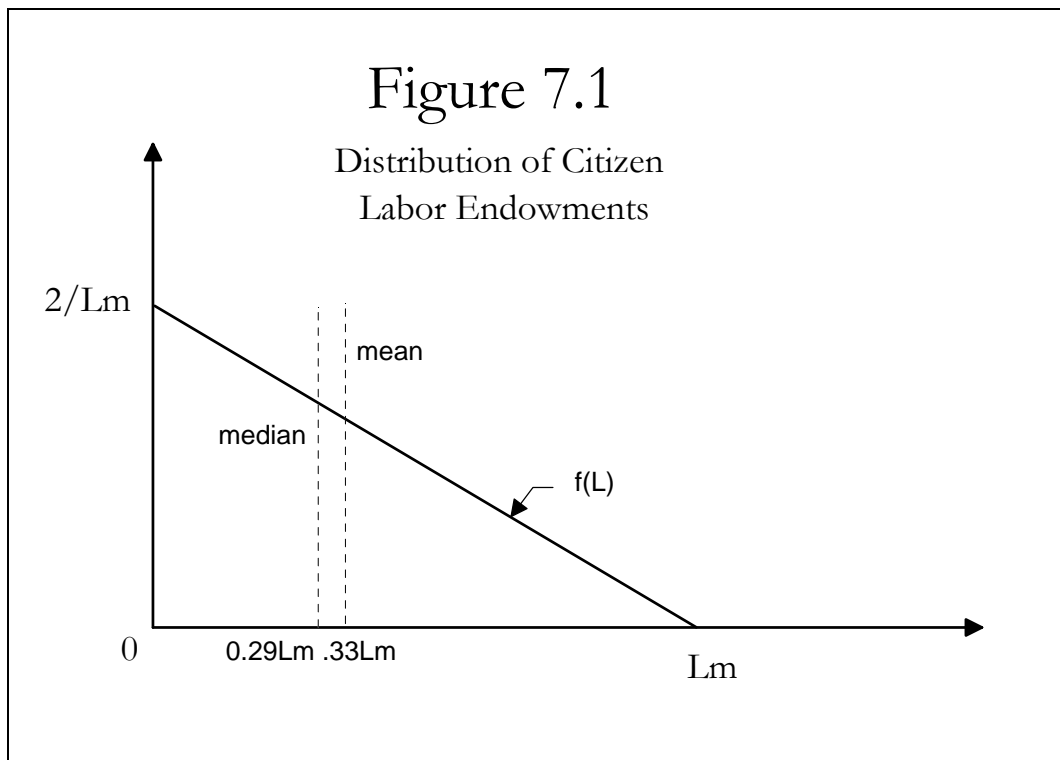
$$G^* = g( wL_i + rK_i, Y, Z) \quad (7.3)$$

Each citizen demands services based on his or her endowment of labor and capital, the marginal product of those inputs and national income. Because only the initial endowments of productive inputs vary by person in this model, it is the variation in the initial endowments that determines the distribution of citizen demands for government services. Suppose that the frequency distributions of labor and capital are approximately independent and can be approximated with

triangular distributions, with labor endowments distributed between 0 and maximal labor endowment,  $L^M$ , where  $l(0) = 2/L_M$  and  $l(L_M) = 0$ , and capital endowments distributed between 0 and maximal capital endowment  $K^M$  with  $k(0) = 2/K_M$  and  $k(K_M) = 0$ .

*The Median Voter Is Determined By Suffrage Law*

Figure 7.1 depicts a triangular distribution of labor endowments and labor-based incomes. The triangular assumption is not crucial for the present analysis, but does assure that voter interests differ somewhat and that median income is below average income, as tends to be the case in most observed income distributions, particularly in societies with little occupational mobility.



The distribution of income,  $Y_i$ , can be written as  $Y_i \sim rL_i + wK_i$  within the domain of realized incomes.<sup>57</sup> The mean of this income distribution is  $Y_A = (rK_M + wL_M)/3$  and its median is  $Y_v = (wL_M + rK_M)(2 - \sqrt{2})/2$ .<sup>58</sup>

<sup>57</sup> The sum of two linear monotone decreasing functions is also linear and monotone decreasing.

<sup>58</sup> The two triangular density distributions can be written as  $F_L = (2/L_M - 2L/L_M^2)$  and  $F_K = (2/K_M - 2K/K_M^2)$ . Average income is denoted  $Y_A$  and can be characterized with:

Continued on next page...

In a polity in which all citizens are eligible to vote and a median voter exists, two-candidate or two-party competition for office tends to converge to the policy preferences of the median voter. In most contemporary models, the median voter can be represented as the *citizen* with the median endowment of capital and labor.

The median voter is, however, not always the citizen with median endowments or income, because the distribution of endowments among potential voters may differ from that of the persons lawfully entitled to vote. In modern democracies, suffrage eligibility is determined by citizenship and age, with the consequence that the median voter is older than the median citizen. (Children and foreign nationals cannot vote.) For much of the history of parliamentary systems, eligibility to vote was determined by tax payments and/or land ownership, as noted above. In the medieval context, the median voter was generally a citizen with much greater income than that of the median citizen.

In the context of model, suffrage restrictions simply change the identity and service demand of the pivotal voter. Suppose that citizens are allowed to vote whenever their labor-based tax payment is greater than  $T^L$  or their capital-based tax payment is greater than  $T^K$ . Suppose that the tax constitution limits taxes to a single rate sufficient to pay for government services,  $t = c(G^*, Z)/Y$ . Whether a person qualifies as a voter or not in this case varies both with his endowment of productive assets and the government service level. That is to say, citizen  $i$  can vote if his quality-adjusted labor endowment,  $L_i$ , satisfies  $twL_i > T^L$  or if his capital,  $K_i$ , endowment satisfies  $rK_i > T^K$ , where  $t$  is the prevailing average tax rate,  $w$  is the typical wage rate and  $r$  is the rate of return on capital.  $L_i$  can be thought of as the quality of citizen  $i$ 's labor endowment, which varies with his education, experience, and health. (Women could rarely vote before 1900.)

Note that it is possible to shift between tax payment and endowment-based suffrage laws without modifying the basic structure of the model. Given the prevailing national prices for capital

$$Y_A = \int_0^{L_M} wL(2/L_M - 2L/L_M^2)dL + \int_0^{K_M} rK(2/K_M - 2K/K_M^2) dK$$

or

$$Y_A = (rK_M + wL_M)/3$$

The medians of labor and capital distributions are  $L_v = L_M(2 - \sqrt{2})/2$  and  $K_v = K_M(2 - \sqrt{2})/2$ , respectively, given the assumed triangular distributions. Median citizen income is, consequently,  $Y_v = (wL_M + rK_M)(2 - \sqrt{2})/2$ , where  $w$  and  $r$  again reflect the marginal product of labor and capital for the total employment of labor and capital. Note that  $(2 - \sqrt{2})/2 = 0.2929 < 1/3$ ; median income is less than average income. Triangular distributions are skewed distributions with different modes, means, and medians.

and labor, citizens with a labor endowment greater than  $L^E$ , with  $L^E = T^L/tw$ , or with a capital endowment greater than  $K^E$ , with  $K^E = T^K/tw$ , are able to vote.

Eligibility to vote in such systems is partly based on endowments, partly on productivity (insofar as marginal productivity is reflected in wage rates and the return on capital), and partly on the general price level. For the present analysis, assume that the economic determinants of wage rates and the rate of return on capital are stable. This would tend to be the case in economic steady states and for short-run analysis, for which it is normally assumed that a constant supply of capital and labor is employed using a particular production technology.

Under these conditions and a triangular distribution of the endowments,  $L_V$  and  $K_V$ , the median holding of capital and labor will satisfy:

$$\begin{aligned} &_{TL/tw} \int^{L_V} w(2L/L_M - L^2/L_M^2) dL + _{TK/tw} \int^{K_V} r(2K/K_M - K^2/K_M^2) dK \\ &= _{L_V} \int^{L_M} w(2L/L_M - L^2/L_M^2) dL + _{K_V} \int^{K_M} r(2K/K_M - K^2/K_M^2) dK \end{aligned} \quad (7.4)$$

in which case, the median voter's income is:

$$Y_v = ( w (L_M - T^L/tw) + r (K_M - T^K/tw) ) ( 2 - \sqrt{2} ) / 2. \quad (7.5)$$

and he or she will demand service level:

$$G^* = g( Y_v, Y, Z) \quad (7.6a)$$

or

$$G^* = \gamma( L_v, K_v, T^L, T^K, Y, Z) \quad (7.6b)$$

Note that *suffrage rules partly determine government policies* by determining the identity of the median voter and the composition of parliament.

### *A Pragmatic Median Voter's Lack of Interest in Suffrage Reform*

Suffrage laws in most polities can be modified through acts of parliament. Equation 7.6b allows the present median voter preferences over election law to be characterized with the indirect utility function:

$$U_v^* = u(1 - C(\gamma( L_v, K_v, T^L, T^K, Y, Z), Z)/Y) Y_v, \gamma( L_v, K_v, T^L, T^K, Y, Z) \quad (7.7)$$



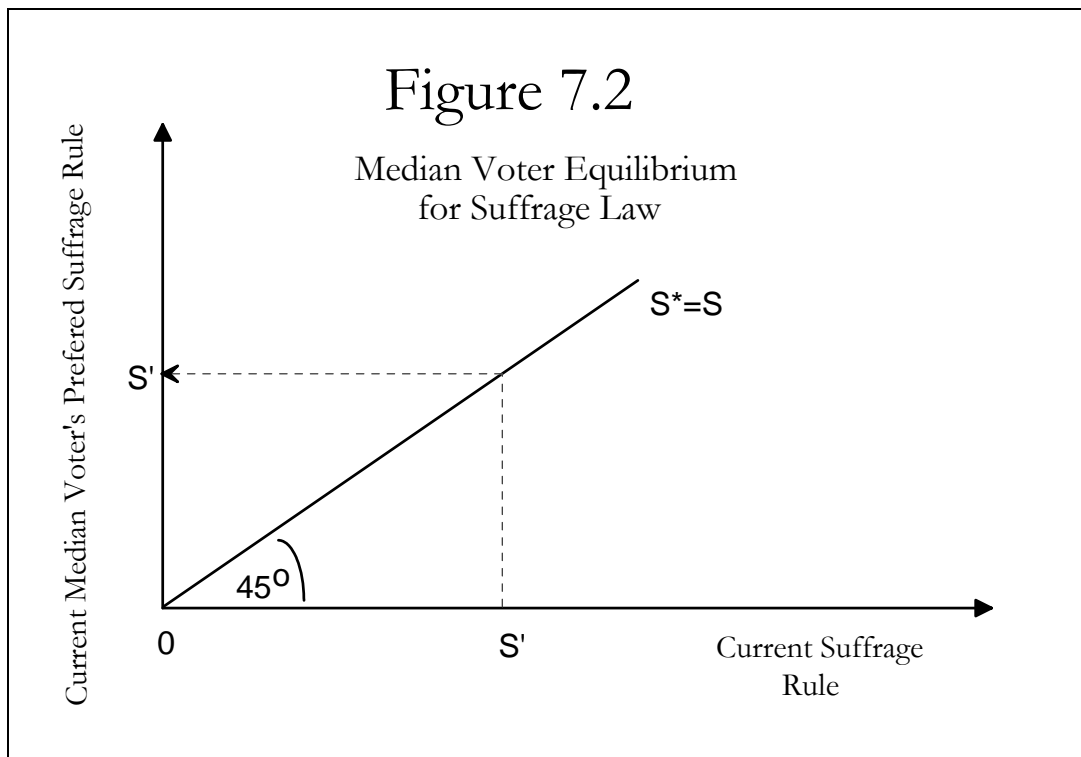
Differentiating equation 7.7 with respect to  $T^L$  and  $T^K$  and applying the envelope theorem allows the first-order conditions for the median voter's optimal suffrage laws to be characterized.

$$U_V^*_{TL} = (u_X C_G - u_G) G_\gamma \gamma_{TL} = 0 \quad (7.8a)$$

$$U_V^*_{TK} = (u_X C_G - u_G) G_\gamma \gamma_{TK} = 0 \quad (7.8b)$$

Equations 7.8a and 7.8b imply that the present suffrage qualifications  $T^L$  and  $T^K$  are *already optimized for the present median voter*. No other combination of wealth requirements for suffrage will generate a better service-tax combination for the pivotal voter, because the present value of  $G^*$  maximizes the median voter's welfare under the present electoral laws (and the assumed tax constitution).

The median voter at a given point in time is completely satisfied with the existing suffrage law,  $S'$ , because these made him the pivotal voter! Other things being equal, the present median voter is content to be the median voter and has no interest in enacting laws that will "worsen" policy by creating a new pivotal voter. *The use of majority rule to select members of parliament and/or within parliament for selecting policies does not by itself generate a political impulse for universal suffrage.*



*Economic Growth Cannot by Itself Induce Liberal Suffrage Reform*

During periods of economic growth, income and tax payment based suffrage laws tend to become less restrictive through time as capital is accumulated and government services expand, because these tend to increase income, wealth, and tax payments. Technological advance further increases income by increasing the productivity of labor and capital, and in many cases land as well. Wealth-based rules for suffrage consequently imply that a somewhat larger electorate and somewhat new median voter tend to emerge in every election cycle during periods of economic growth and during periods of economic contraction.<sup>59</sup>

The direct electoral effect of economic growth on suffrage under stable tax- or income-based suffrage rules thus tends to make the present median voter somewhat worse off. After all, it is only by being the median voter that a particular citizen can realize his or her most preferred government service levels. Consequently, the median voter's desire to maintain his position as median voter is not entirely compatible with a stable set of tax- and wealth-based rules for voter eligibility in a setting in which wages or returns from capital increase through time.

Perhaps surprisingly, if the present median voter always had his (or her) way on suffrage reform, economic progress would tend to be associated with electoral rules that gradually become *more demanding*, rather than less demanding, through time. A forward-looking median voter would be inclined to tighten the eligibility rules for suffrage by increasing the wealth or income requirements for electoral qualification, so that he or she remains the median voter as economic growth takes place.<sup>60</sup>

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<sup>59</sup> This purely economic route to suffrage expansion in periods of rapid growth can be as important as major reforms of suffrage laws. This method of obtaining suffrage was historically important in the United Kingdom and Sweden, where suffrage rates approximately doubled, largely as a consequence of income increases, rather than suffrage reform.

<sup>60</sup> There are a few historical cases in which suffrage reforms gradually introduced more restrictive qualifications for the right to vote. For example, in 1620–63, there was essentially universal free male suffrage for selecting the members of Virginia's colonial parliament (although restricted somewhat by a poll tax), after which suffrage was limited to "freeholders" and increasingly restrictive definitions of freeholder were introduced. By 1736 the franchise was limited to white male Protestant freeholders (owning at least a 100 acres of land) and who were 21 years of age and resided in the counties in which they offered to vote. See McKinley (1905: ch. 2). Similar reductions in the scope of suffrage were also common in the other colonies in the early eighteenth century.

## B. Taxation Through Representation as a Motivation for Suffrage Reform

The tax constitution implicit in the model used to this point allows the government to tax anyone that it wishes, although all taxpayers must be taxed at the same rate and upward revisions of that rate are subject to parliamentary veto.

Suppose instead that the tax constitution limited the tax base to those with the privilege of suffrage. That is to say, suppose that it allowed direct taxation of only those directly represented in parliament. Such reasoning clearly played a role in the early European and American theories of representation, insofar as only substantial taxpayers were given the privilege of voting and were eligible for positions in parliament and those not represented were not directly taxed. Similar logic also applies to settings in which territorial boundaries limit the tax base and electorate. If a group petitions to be included in a polity, it normally negotiates for representation and suffrage rights along with its new tax obligations. In such cases, suffrage rules simultaneously determine the identity of the median voter and the tax base available to the polity.

When a polity's tax base is affected by the degree of suffrage, the present median voter and his representative in parliament may have a practical fiscal interest in suffrage reform. The median voter's ideal suffrage level in this institutional setting can be characterized by modifying equation 7 to take into account the effect of changes in suffrage on the tax base  $Y$ . Let  $Y$  be redefined as the size of the income tax base, which under the assumed tax constitution is a decreasing function of the wealth or income-tax qualifications for suffrage,  $Y = y(T^L, T^K)$ . Changes in suffrage laws will generate a new median voter who will have different demands for public services and also for suffrage laws. The fiscal effects of the new median voter is accounted for by the implicit function describing  $G^*$  and in the cost-sharing rule through effects on the ratio of median income to national income  $Y_v/Y$ .

The present median voter's own income,  $Y_v$ , is not affected by changes in suffrage although his future tax price for government services is affected. The present median voter's preferred suffrage eligibility rule now maximizes:

$$U_v = u([1 - C(G^*, Z)]/y(T^L, T^K))Y_v, G^* \quad (7.9)$$

$$\text{with } G^* = \gamma(L_v, K_v, T^L, T^K, y(T^L, T^K), Z)$$

which requires:

$$U_{vTL} = [u_x(-C_G/Y)Y_v + u_G]G^*_{TK} + u_x[Y_{TL}C(G^*)Y_v/Y^2] = 0 \quad (7.10a)$$

and

$$U_{VTK} = [u_x (- C_G / Y) Y_v + u_G] G^*_{TK} + u_x [( Y_{TK} C(G^*) Y_v / Y^2 ] = 0 \quad (7.10b)$$

The first set of bracketed terms are the effects of increased suffrage restrictions on government services and the costs of those services; the second set of bracketed terms characterizes the effect of suffrage restrictions on the overall tax base.

Consider, first, the case in which the income of the new median voter is approximately the same as that of the present one. This case might arise, for example, when non-income-based requirements for suffrage are relaxed. Another territory may join a confederation; suffrage may be extended to another profession or organized interest group; residency, race, or sex qualifications may be dropped. In such cases, the marginal effects of suffrage rules on  $G^*$  can be neglected, because the new distribution of voters has approximately the same median voter,  $u_x (- C_G / Y) Y_v + u_G = 0$ . In that case, equations 7.10a and 7.10b imply that the median voter will expand suffrage until the *tax base is maximized*, which occurs at the point where  $Y_{TL} = Y_{TK} = 0$ . In the limit, essentially all taxpayers may be allowed to vote in this case, although not nontaxpayers.

In the case in which the income of the new median voter is expected to differ from the present one, service levels and tax rates will change. In this case, the first-order conditions imply that the present median voter will tradeoff advantages from a greater tax base (and lower tax rates) against marginal losses from changes in government services. Note that it is possible that no reform of suffrage laws will be adopted in such cases, in spite of the advantages of a broader tax base. The marginal losses from new service and tax levels may be larger than the median voter's marginal tax savings from a somewhat broader tax base. Only if the anticipated tax savings more than offset marginal losses from "suboptimal" service will suffrage be expanded.

In the later case, however, reforms may still be blocked. It is possible that all successive median voters would prefer continued expansion of the tax base. A slippery slope may be said to exist in such cases, because an initially small increase of suffrage might be gradually expanded to include all taxpayers as a series of suffrage expansions are adopted and ratified by successively poorer median voters. Economic growth could play a role in such "slippery slopes" for suffrage reform, insofar as economic development increases the wealth and tax worthiness of relatively low income citizens. Note, however, that a forward looking median voter, who felt that the resulting fiscal package was inferior to the initial one would be inclined to block otherwise desirable suffrage reforms to avoid

the slippery slope. In either case, suffrage laws are stable only if a median voter is reached that opposes further changes in suffrage.

These tax-base explanations of suffrage expansion are internally consistent, but they depend upon a somewhat strong assumptions about median voter expectations and the existence of a peculiar tax constitution under which only the enfranchised can be taxed. In most cases, breaking the link between tax payments and suffrage and simply expanding taxation without expanding suffrage would have broad support within parliament. Changing the tax base would expand the potential scope of public services, salaries, honors, and so forth for all those currently eligible to vote without the undesirable policy effects of a new median voter and median representative.

Given this, most members of parliament would *vote to eliminate a suffrage-based taxation restriction*, and nonvoters would be taxed without expanding suffrage. A suffrage-based tax constitution tends to be unstable.

### *Practical Difficulty of Fine Tuning Electoral Laws*

It also bears noting that the members of parliament tend to have an interest in preserving the suffrage laws that brought them to office. Changes in the rules governing suffrage are major policy decisions that are likely to change existing coalitions of political interests in each district or party. Consequently, debate on suffrage issues tends to be extensive and normally runs through several parliaments. The rules that determine voter qualifications are usually more difficult to change than ordinary policies are, because they are quasi-constitutional in nature. This increases the stability of suffrage laws beyond that implied by the median voter's pragmatic interest in continuing to be the median voter.

The stability of suffrage law is further reinforced by the institutional conservatism of both voters and members of parliament. It is clear that political uncertainty would increase if election laws were routinely revised every time that parliament met. Risk aversion among the members and their voters supports stable suffrage laws, other things being equal. Stable electoral systems may be further supported by widely held norms that include stability, predictability, and tradition as desirable features of existing political systems, especially among those already entitled to vote. Moreover, stable election laws also reduce the ability of a temporary majority to capture parliament and thereby governance permanently (Congleton 2003a). The median member of parliament is, thus, inclined to resist changes in suffrage law.

Differences in individual circumstances, tastes, and ideology, however, imply that many citizens tend to be dissatisfied with the present rules governing suffrage, including many who are entitled to vote. For example, voters with relatively large capital, land, or labor holdings tend to prefer more restrictive rules. Voters with smaller endowments tend to prefer less restrictive rules. For these dissatisfied citizens, election law reform can potentially generate a new median voter whose preferred policies are closer to their own.

### **C. Protests, Revolutionary Threats, and Suffrage Reform**

Given the absence of “spontaneous” economic pressures for reform, those not represented in government may try to organize themselves to press for reform through persuasive means and in extreme cases to threaten a revolution against the present institutional arrangements. Both types of organizations are difficult to organize, because those whose interests are advanced by the current institutions of government are already organized in a manner that allows them to oppose such efforts. Persuasive campaigns are likely to attract less attention from government than revolutionary ones, because the risks are smaller for those favoring the status quo. A persuasive campaign, as such, only exposes proponents of the status quo to unpleasant arguments.

#### *Organizing a Peaceful Persuasive Campaign*

Politically active interest groups are organized for reasons similar to those of other organizations. There are economies of scale that can be realized by developing persuasive arguments, organizing meetings of persons with shared interests, in lobbying members of parliament, and in organizing peaceful demonstrations that reveal the breadth of support for a given policy or reform. Formateurs, thus, may attempt to form political organizations if they can “profit” from such organizations either financially or by significantly increasing the likelihood of desired reforms.

Game matrix 7.1 illustrates how rewards and penalties can be used to encourage and discourage political organizations and public protests. The game to the left of the matrix is the “natural” assurance game of political organization. The game to the right characterizes how rewards,  $R$ , and penalties,  $P$ , can be engineered to encourage or discourage participation in the political organization. (To simplify the exposition, it is initially assumed that both rewards and penalties are realized with certainty.)

<b>The Assurance Game for Popular Demonstrations</b>			<b>Table 7.1</b>	<b>Organizational Solution for Popular Demonstrations Opposed by Government</b>	
	Potential Protester B			Potential Protester B	
	Protest	Stay Home		Protest	Shirk
Protest (A)	3, 3	0, 0	Protest (A)	$3+R - P, 3+R-P$	R-P, 0
Stay Home (A)	0, 0	$1, 1$	Shirk (A)	0, R-P	1, 1
Exit (A)	1, 1	1, 1	Exit (A)	1, 1	1, 1

The cell entries are utilities, the rank order of subjective payoffs for the team members (A, B). In the “natural case,” it assumed that both team members shirk, for example, conduct their ordinary private lives.

The potential gains from organization are 4 units in the illustration,  $(3+3) - (1+1)$ . These unrealized gains imply a formal political organization can potentially be fruitful for its members and leadership. In the absence of governmental opposition ( $P=0$ ), rewards greater than 1 unit are sufficient to induce attendance at the organization’s meeting or mass demonstration.

If, however, formateurs can provide a reward of  $R>P+1$  in the “Protest Game” participants will find it to their private advantage to assemble at the designated time and place and participate in public demonstrations supporting suffrage reform or other policy changes. It is partly to increase  $R$  that political organizers often include music, food, rousing speeches, prayers, and other forms of entertainment at their meetings and mass demonstrations in settings in which expected penalties are small. The required coordinating reward decreases when the organized forms of political expression are enjoyable activities for significant numbers of persons, or if participation in large gatherings of persons who share “important goals” is satisfying or comforting for the participants.

Efforts to organize groups favoring major policy and procedural reforms are often opposed by the persons already represented in government, because they benefit from current policies. Their representatives can, for example, pass laws that impose penalties on political formateurs and on those participating in public demonstrations of support for new policies. Most societies, consequently, have laws that govern large gatherings, and many have laws that regulate the formation of organizations with public policy agendas. Even relatively liberal regimes may have rules on what can and cannot be published in newspapers and books.

Significant punishments for organizers and for participating in demonstrations makes such demonstrations more difficult to organize. As a consequence, mass protests tend to be associated with governments that are already relatively liberal, insofar as such regimes tolerate law-abiding

interest groups and peaceful demonstrations favoring changes in existing policies (i.e. they have low or no penalties for such activities). Such demonstrations are also possible in cases in which governments are failing, in the sense that they are considered to be unable to impose penalties on large numbers of demonstrators.

Penalties in liberal regimes, however, can be rationalized in a variety of ways. Additional law enforcement is often thought necessary for crowd control, but is not always sufficient to discourage thuggery of various sorts, although it is always expensive to provide. Moreover, property destruction and fights tend to reduce the perceived effectiveness of the government's law enforcement abilities and diminish the efficiency of its efforts to police other crimes, which further increases the costs of law enforcement in general. Even minor penalties may be sufficient to discourage most mass demonstrations of support or opposition to current public policies and institutions.

Such threats, of course, need not lead to large numbers of convictions in practice. To the extent that the promised punishments are credible, relatively few protests take place and no punishments are necessary. Domestic pressures for reform can, thus, often be diffused by relatively liberal and relatively weak governments. The finite nature of the gains from policy reform implies that a finite expected penalty,  $P$ , exists that is sufficient to discourage all organizations of moderate men and women. In the case illustrated, a penalty greater than 3 is sufficient to discourage the formation of political organizations and would cause an organized group to disintegrate. Given  $R < 3$  and  $P > 3$ , each potential protester finds him or herself better off free riding (staying at home) than protesting regardless of choices made by others.

### *Repression and Revolution*

The organization of a revolt tends to be much more difficult than organizing peaceful public demonstrations. Revolutions against a well-organized government require a strong military organization in addition to convincing arguments, pamphlets, speeches, mass meetings, and petitions. The cost of participating in revolutionary movements also tends to be far greater in both the planning and execution stages. More resources are needed, and because revolutions imply loss of life and property, they are resisted more aggressively by those favoring the status quo. These and other strictly military problems imply that formal revolutionary organizations (armies) are likely to be better able to produce the physical threats required than are informal "natural" organizations (mobs).



Armies have long been more effective than mobs and other unmanaged groups. This is, of course, why village and national defense is normally an organized activity, rather than an unorganized activity left to spontaneous citizen efforts at defense.

To win a “revolutionary” civil war, a preexisting standing army has to be defeated, which tends to be difficult even when the government’s army is poorly organized. This requires (1) conditional rewards that are relatively great, (2) threatening non-participants with penalties that are comparable to those imposed by the government for participating, and/or (3) reducing the (expected) penalties that the government can impose through secret meetings and promises to protect all members. However, none of these steps are easy. Nonetheless, the essential problem of organizing a revolutionary army is similar to that of any other organization.

The essential logic of revolution can be illustrated with another highly simplified game matrix. Assume that there are just two possible outcomes, the status quo ante and the outcome of a successful revolt. The difference between a person’s net benefits in the pre- and post- revolutionary state can be called their “stake” in the revolution. In principle, an individual’s revolutionary stake can be positive or negative according to whether he or she expects to be better or worse off if the revolution succeeds. The main difference between peaceful and revolutionary groups is the effect of organizational size on the probability of success. Even a single very persuasive author may directly change a lot of minds, but a single assassin can only change a handful of leaders.

In robust governments, such leaders are routinely replaced as they die from what ever cause. No man nor subset of leaders can be irreplaceable in a durable government, although policy formation may be temporarily disrupted as replacements are recruited and learn their new roles.

The probability of military overthrow of a durable government increases as the number of active participants increases over a fairly broad range, because the organization’s own internal incentives may be overcome or because the organization itself may be conquered.

The ability of a government to discourage such organizations is affected by a variety of resource considerations, including the size and discipline of its own military and law enforcement systems, as well as the internal support for the present government and support within the community at large (who may provide information about conspirators). In the case in which the government imposes expected penalty  $P$  on members of the revolt and the revolutionary organization provides reward  $R$  for membership, an individual’s decision to join can be illustrated in table 7.2.

**Table 7.2: The Revolt Game  
for Constitutional or Policy Reform**

Strategies	Number of Revolters				
	0	1	2	m	All
Join Revolt	P, P	$(1/n)^{(1-g)}S + R - P$	$(2/n)^{(1-g)}S + R - P$	$(m/n)^{(1-g)}S + R - P$	S + R
Do Not Join	0	0	0	0	0
Exit	E	E	E	E	E

The cell entries are expected utilities, S is the net benefit of successful revolt, R is the reward of participating in the revolution, and P is the expected penalty associated with participation. E is the net benefit of moving to another community. In a community with a stable population,  $E < 0$ .

Suppose that the probability of successful revolution is  $F = (m/n)^{(1-g)}$ , where m is the membership of the revolutionary organization, n is the number of persons in the community at large, and g represents the government’s ability to resist revolutionary pressures. (To simplify exposition, it is assumed that all participants are risk neutral, which tends to favor the formation of revolutionary organizations relative to alternative assumption of risk aversion.) If  $(m/n)^{(1-g)}S_i + R - P > 0$ , then individual *i* joins the revolt.

Even in this simple representation, the decision to join or not is affected by a number of considerations. For individuals with positive stakes in the revolt, there will be a membership size,  $m^*$ , beyond which participating in the revolt increases expected utility. If the organization is smaller than  $m^*$ , individuals choose to free ride.

In the special case in which all persons have the same stake,  $S > 0$ , the game resembles the assurance game above, in the sense that if all would join if  $m > m^*$ , because the result would be better than the status quo. In such cases, either the unrepresented part of society revolts or it does not. It is also clear that an effective government can easily manipulate *P* and *g* to assure the absence of revolutionary organizations in such cases.

In settings in which the stakes vary within the community of potential revolutionaries, membership does not necessarily fall to zero for finite values of *P* and *g*. The smallest group that a person *i* will join is  $m_i^* = (n)[(P-R)/S_i]^{1/g}$ , which falls as stakes, *S<sub>i</sub>*, organizational rewards, *R*, increases and increases with population, *n*, and expected penalties, *P*. Persons with very high stakes tend to be persons with strong religious and ideologically motivated policy goals, in addition to pragmatic economic and political goals. Some revolutionaries may have very large stakes, indeed infinite ones, at issue. Such idealist-fanatics will be more inclined to join small, risky, secret revolutionary associations than pragmatists with only economic stakes in changing government policies.

As long as the government retains the loyalty of those charged with imposing punishments and is reasonably efficient, it can increase expected punishments sufficiently to discourage the formation of large revolutionary organizations, even in high stake settings. Secret organizing efforts can be discouraged by imposing high penalties on political organizers and those discovered to have attended their meetings. Spies can be hired to determine secret meeting times and locations. The death penalty for “conspiracy” and “treason” have long been included among deterrents, which can discourage participation for all but fanatics.

Such governmental strategies can essentially eliminate publicly organized political meetings and demonstrations. The lack of significant protests, in turn, may cause those weakly in support of revolution to believe that support for the government is stronger than it actually is. When confronting effective authoritarian regimes, in which penalties for organizing opponents are severe, credible promises (and threats) of revolution are difficult to make.

In some unusual circumstances, particularly in relatively ineffective regimes, a political or economic crisis can increase  $S_i$  to very high levels for many persons in a given society, and cause large revolutionary groups to form rapidly, as argued by Koran (1989) and Weingast (2006). Moreover, as Kuran (1989) points out, increasing levels of active public support increases the perceived probability of success,  $F$ , and decreases the perceived probability of punishment,  $P$ , which tends to further increase the size of movements. However, if such organizations are not able to generate enough resources to be self-sustaining and successful, even relatively large revolutionary groups may disintegrate, as noted by Ferrero (2002).

Indeed, potential formateurs and potential members may simply emigrate from their home community in such cases, because their exit options tend to be relatively more attractive than those at home,  $E > 0$ . It is often expedient for revolutionary “leaders” to talk about revolution while safe in a foreign land, rather than to organize and conduct the required military operations at home. As a consequence, *ex patriot* communities often include many self-described revolutionary “leaders,” although revolutions are less commonplace. In cases in which a revolution eventually does succeed against all odds, subsequent *ex patriot* communities normally include “counter revolutionaries,” such as displaced kings and their retainers.

### *Palace Coups Rather than Democratic Revolutions*

An effective government can often impose relatively large penalties ( $P$ ) on revolutionary participants without inducing fear among nonparticipants (which tends to increase  $S$  and  $E$ ) and

without indicating that the group is relatively large (and thus, possibly, worth joining). Laws against treason will be aggressively enforced; rewards for providing the ruler(s) with creditable evidence of conspiracies will be high; commissions, rather than individuals, may be given responsibility for internal policymaking (to minimize risks from internal defections); and potential rivals to present government leaders may be rotated or exiled in a manner that reduces opportunities for opponents to acquire support within or outside government. A successful revolt tends to require relatively high stakes (high  $S$ ), relatively high rewards ( $R$ ), and relatively weak governance (low  $g$ ), as argued by Tullock (1974, 1987).

Consequently, small groups operating within government often have better prospects for changing governance than large groups operating outside of government. The larger scale of external conspiracies makes them easier to detect and punish than smaller internal ones. The private advantages of participating in a palace coup also tend to be greater than those associated with a popular uprising. Although the aggregate benefits obtained by replacing extractive or dysfunctional governments can be very large, only a few persons are likely to gain positions of authority (or wealth) in the new government. Insiders can silently shift their support among competing factions on the basis of anticipated success, and secure greater expected personal benefits at somewhat lower expected cost. Consistent with this analysis, there is a good deal of evidence that palace coups are organized more frequently and succeed more frequently than popular revolts (Bienen and Van de Walle 1989, Tullock 1987: 9).

It bears noting that even a successful revolution is unlikely to establish liberal democratic reforms. Revolutionary formeteurs are usually charismatic individuals. Their organizations often have governments based on the king and council template, with a powerful executive and a small councils of fellow activists. As true of other organizations, revolutionary formeteurs normally desire to retain control of their organizations after it is up and running. Their success against all odds clearly demonstrates that “their” leadership and “their” organization’s government are unusually effective. As a consequence, most organizations that overthrow a government are inclined to retain their standing “pre-revolutionary” procedures for making policy decisions. That is to say, revolutionists are inclined to be *institutionally conservative*, after the war is won.<sup>61</sup>

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<sup>61</sup> For example, it bears noting that George Washington was not a formeteur, but rather the agent of a council of colonial leaders, most of whom were representatives of elected colonial governments (state parliaments). The first national government of the United States simply

Continued on next page...

## **D. Rational Choice and the Long Run Stability of Suffrage Law**

Overall, this chapter suggests that suffrage laws can be stable for long periods of time, whether they are broadly supported or not. The stability of narrow suffrage laws for selecting members of parliament is not an accident. There is nothing inherent in majority rule that inclines voters or those elected to expand suffrage to new voters. The existing median voter will normally prefer the rules that allow him (or her) to substantially determine public policies over other suffrage rules. This satisfaction with narrow suffrage laws is not affected by changes in voter income, and it tends to be true of standing regional governments. It also tends to be true of the leaders of groups who manage to overthrow a preexisting government. Stable suffrage laws simply require a sufficient consensus among those with the authority to adopt reforms that the status quo procedures advance their personal and organizational interests.

Although this analysis seems to suggest that only revolutions can expand suffrage, a very similar logic implies that democratic revolutions are unlikely to occur. Revolutionary groups are difficult to organize, and in those few cases in which outsiders orchestrate a successful civil war against the existing government, the advantages of hierarchy, discipline, and secrecy in fighting such wars, together with institutional conservatism tends to favor a continuation of the revolutionary organization's own hierarchical methods for decision making, rather than the adoption of the radically more open and competitive ones of democracy. Overthrows of governments by insiders are more common than those organized by outsiders, but in such cases the old institutions are normally preserved, although the persons holding particular offices of authority are replaced. Palace coups are not constitutional revolutions.

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constitutionalized the system used to orchestrate the war of independence. The individual member state governments were also very similar to the colonial governments that they replaced (see chapter 18). George Washington continued to defer to both the national and state governments after the war was won.

The *Articles of Confederation* adopted in 1781 (somewhat before the war was over) was partly a mutual defense treaty among colonial-state governments. Article 1 states that "Each state retains its sovereignty, freedom, and independence and every power, jurisdiction, and right, which is not by this Confederation expressly delegated to the United States, in Congress assembled." Article 2 clearly states that "The said States hereby severally enter into a firm league of friendship with each other, for their *common defense*, the security of their liberties, and their mutual and general welfare, binding themselves to assist each other, against all force offered to, or attacks made upon them, or any of them, on account of religion, sovereignty, trade, or any other pretense whatever."

In both conservative and revolutionary governments, the existing selection rules tend to advance the interests of those who already are represented in government. Consequently, persons in high offices are predisposed to protect the procedures that were responsible for producing “their” authority within “their” organizations.

In some cases, efforts to avoid revolution may generate broad support for the existing institutions (especially in conjunction with institutional conservatism) by encouraging patriotism and economic growth, but in other cases (perhaps most) suppressing revolutions is produced by making reform campaigns very difficult to organize. New ideas and new organizations were routinely censored in medieval and early modern states. Even mildly revolutionary tracts were normally circulated were published anonymously or under an assumed name. Very conservative states often punish all novel ideas, as blasphemy or treason. As states liberalize, censorship is gradually reduced in scope, but the last area of censorship to be lifted is normally that with respect to political reform.

For existing suffrage laws to change, the policy interests of those with the authority to change the laws governing political participation must also change.

## **Chapter 8: Ideology, Interest Groups, and Adult Suffrage**

The analysis of the previous two chapters suggests that the rise of parliament and the expansion of suffrage are not necessarily connected with each other. There are many occasions on which parliaments may gain policymaking authority, without producing similar gains to trade between those eligible and not eligible to vote. Chapter 6 suggests that changes in the distribution of income, new technologies of production (and destruction), and changes in the person holding the royal office may induce changes in the distribution of policymaking authority between the king and parliament. Chapter 7 suggests that those same changes would not produce a majority in parliament in favor of suffrage reform. Revolutionary threats and palace coups may also affect the balance of authority between the king and parliament, without producing suffrage reform. Fear of revolution, for example, may increase executive power, which may be used to discourage participation in politically active interest groups. Shifts of authority between a king and council, consequently, are predicted to be more common than changes in suffrage laws. Conversely, it also bears noting that parliaments may be elected by very broad suffrage without producing democratic rule, if parliament itself has little policymaking authority.

The avenues for suffrage reform examined in this chapter are also ones that may produce new gains from constitutional exchange between the king and parliament, which provides a possible explanation for their correlation in several historical cases, although it is their effect on suffrage that is focused on. The first focuses on normative or ideological interests in suffrage that individuals may have in addition to their economic interests. That norms may influence behavior was discussed in chapter two, when analyzing composite incentive systems. In that chapter, it was shown that some norms can reduce various intra-organizational prisoner dilemma and coordination problems in a cost-effective manner, which induces organizations to use and encourage such norms. How changes in a subset of such norms may induce changes in suffrage laws is examined below.

The other possibilities are also partly a consequences of policy relevant norms, but also of the informational and economic circumstances in which policy choices are made. If norms affect public policy choices and constitutional reforms, normative theories may be promoted as a means of influencing governance. If informational shifts can affect public policy, then the production of some kinds of information may be promoted as a method of influencing public policies.

As noted in the previous chapter, organized interest groups are not always tolerated. Nonetheless, a government that is able to bring new ideas and new facts under consideration is likely

to be able to better adapt to changing circumstances than ones that discourage all policy-relevant debate. In such settings, (limited) internal and external debate can be defended on the pragmatic grounds that it increases a government's net revenues and survival prospects. In polities that tolerate even very limited debate and dissent, formateurs will often have an interest in organizing groups that attempt to influence public policy decisions. There are several non-revolutionary strategies through which organized groups of "outsiders" may be able to influence public policy decisions made by "insiders."

The norms that are relevant to suffrage reform and other constitutional reforms are the subset of normative theories that attempt to characterize "proper" behavior or institutions for groups of persons or for society at large. Social norms tend to be universalist, because they imply that all persons in a given society "should" adhere to them. Normative theories often characterize systematic methods for determining whether a society is a good society or not. Economists use the Pareto principles for the latter purposes. Utilitarians use social welfare functions and contractarians use the veil of ignorance construction for much the same purpose. Theology direct persons to particular authoritative texts. The particulars of the normative theories used are not important for the purposes of this chapter, only that such norms exist and that such norms affect politically-relevant behavior.

### **A. A Digression on Normative Interests and Rational Choice**

There is no conflict between rationality and norm-following behavior, although there may be conflicts between one's normative and economic interests. Ordinary economic interests and normative interests, however, are often well aligned, because many normative theories of "proper" behavior are rules of thumb that allow individuals to more effectively advance their economic interests. That is to say, many norms solve various coordination, externality, and asymmetric information problems. A private work ethic that induces one to be a bit more honest and hard working than other team members, also tends to increase one's marginal productivity and wage rates within most organizations. A private ethic of obeying the law and following the rules may open doors to higher positions in one's organization or community in which one's behavior is less subject to monitoring. A private ethic of "doing to others only what you would want them to do to you" tends to internalize externalities, reduce losses from conflict, and encourage trust relationships.

Normative rules and theories that that are well-aligned with economic interests are often culturally supported (e. g. encouraged among children), because the behavior induced by those



norms tends to increase prosperity and reduce unproductive social conflict. Persuading children to adopt such norms is evidently one of the main tasks of parenting and formal education. Good students get their homework done on time, diligently, without cheating. Good work means following the teacher's instructions for the task at hand. Students are encouraged not to be "trouble makers" and about "proper behavior" at the same time that they are encouraged to learn a bit about language, mathematics, and history. Similar lessons are widely taught at home, by religious organizations, and in most other organizations.

As mentioned in chapter two, such norms often are useful for organizations. Team members with particular norms will work hard whether monitored or not, because they have an internal work ethic or internalized norm of promise keeping. Organizations may recruit individuals that have internalized particular norms, because they are easier to motivate and less costly to monitor. Recruiting persons with a "rule following" norm reduces monitoring and enforcement costs within organizations and in society at large. An interest in advancing the application of particular norms can also be the principal aim of an organization, as true of churches and temperance societies.

To say that people have normative aims is not to say that every choice is affected by normative theories, nor is it to say that people have only normative aims. For most people in most settings, advancing normative interests are only a subset of their goals, but this become clear only in cases in which there is a conflict between normative aims and economic, political, or biological ones. In such cases, rational choice models can shed light on the normative-pragmatic tradeoffs that influence decisions made and actions taken. To the extent that norms are internalized, it can be said that advancing normative goals directly increases utility. To the extent that advancing normative goals requires time and attention, there is clearly an allocative problem that can be analyzed using the standard tools from rational choice models. Time, attention, and other resources will be used to pursue normative goals only up to the point where expected (subjective) marginal benefits equal expected marginal costs. In cases in which norms and economic interests are not perfectly aligned, for a given choice setting, there will also be tradeoffs among normative and economic objectives, and even among the norms that might be applied in a given setting.

A very religious person does not normally give all of his or her wealth to the church, because his or her religious goals are only one of many goals and only one of many internalized duties. Such persons have to eat if they are to survive, and feel obliged to take reasonably good care of their children and loved ones as well. Similarly, persons with an ideological agenda are more likely choose to turn out and provide support in favor of policy reforms that advance their ideological goals, when

doing so is likely to be punished, as noted in chapter 7 when discussion revolutionaries. Only zealots, such as suicide bombers, advance normative agenda irrespective of personal costs. At the other extreme, only pure pragmatists are unaffected by normative theories. Most men and women in civilized society trade off normative and pragmatic goals when making day-to-day and long-term choices.

This chapter explores some implications of the subset of normative theories that affect assessments about the proper extent of suffrage. For the past three centuries, there has been a good deal of discussion about just who should be entitled to vote. What qualities entitle one to a vote, or what lack of qualities disqualifies one from casting a vote? Such discussion are nearly always normative in nature. Such norms and discussions can potentially affect a person's assessment of the "proper" degree of suffrage. When they are eligible to cast votes for members of parliament, they may also affect the suffrage laws that exist in a given society.<sup>62</sup>

## B. Some Mathematics of Principled Decisions with Respect to Suffrage

The model of the suffrage demand developed in the previous chapter can be extended to take account of the effects of normative (or ideological) theories of suffrage. For example, one can easily extend the model to analyzed the suffrage laws preferred by a person who favors universal suffrage. This is not the only suffrage norm that one can imagine, but it is relatively easy to model, and analyzing its implications sheds indirect light on other norms.

A person that has internalized the universal suffrage norm has a utility function that increases with the extent of suffrage,  $S$ , *other things being equal*. However, other things are not always equal, so there may be tradeoffs between economic and normative interests, and these will tend to be reflected in both private and public policy choices. To see this, suppose that suffrage levels are again determined by tax thresholds,  $S = s(T^L, T^K)$ , that can be adjusted to secure any suffrage level, and that the "moral voter" is interested in private consumption and public services, as well as universal suffrage. Building on the previous model of the demand for suffrage, such voters will prefer suffrage qualifications that maximize:

$$U = u([1 - C(\gamma L_v, K_v, T^L, T^K, Y, Z), Z)/Y] Y_v, \gamma L_v, K_v, T^L, T^K, Y, Z), s(T^L, T^K)) \quad (8.1)$$

with first-order conditions:

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<sup>62</sup> See Brennan and Hamlin (2000), Besley (2006), and Congleton (2007c) for a broader analysis of how norms can be taken account of in rational choice-based models of governance and public policy choice.

$$U_{TL} = [U_X (-C_G)Yv/Y - U_G ] G^*_{TL} + U_S S_{TL} = 0 \quad (8.2)$$

$$U_{TK} = [U_X (-C_G)Yv/Y - U_G ] G^*_{TK} + U_S S_{TK} = 0 \quad (8.3)$$

where  $S = S(T^L, T^K)$  refers to the percentage of adults eligible to vote given thresholds  $T^L$  and  $T^K$ .

Individuals tend to disagree about the ideal suffrage law for reasons that are similar to their disagreements about other policies. They may have different normative theories and/or different economic interests at stake. The more important normative theories are for a voter's choice, the more "idealistic" or "ideological" that vote can be said to be. The less such norms affect a voter's assessment of suffrage laws, the more "pragmatic" that the voter can be said to be. In this representation of a person's ideal suffrage law, these tradeoffs are characterized by the relative sizes of the marginal utility of personal income,  $U_X$ , public services,  $U_G$ , and the universal suffrage norm,  $U_S$ . Economic man with his narrow utility function is a pure pragmatist, because, by assumption,  $U_S = 0$ .

The models used in chapter 7 are special cases in which pragmatists determine suffrage levels. The new model includes voters favor universal suffrage, but not above all other goals. Applying the implicit function theorem to equations 8.2 and 8.3 allows the typical citizen's demand for voting thresholds to be characterized as:

$$T^{L*} = l(Li, Ki, T^L, T^K, Y, Z) \quad (8.4)$$

$$T^{K*} = k(Li, Ki, T^L, T^K, Y, Z) \quad (8.5)$$

where  $T^L, T^K$  are the existing suffrage laws that produced the present median voter and  $T^{L*}, T^{K*}$  are the new suffrage laws preferred by the present median voter.

### C. Suffrage Norms and Optimal Qualifications for Suffrage

In the absence of an ideological or normative interest in suffrage, as shown in chapter 7, the existing suffrage thresholds are optimal for the median voter. In this case,  $U_S S_{TL} = 0$  and  $U_S S_{TK} = 0$ , the first two terms in the first-order conditions are always satisfied at the present median voter's ideal fiscal package represented as,  $G^*$ . In the case in which suffrage is initially less than ideologically ideal, however,  $U_S S_{TL} \neq 0$  and  $U_S S_{TK} \neq 0$ , and there is a tradeoff between advancing normative and economic interests in suffrage qualifications. In such cases, equations 8.2 and 8.3 demonstrate that normative interests in suffrage create a suffrage-fiscal tradeoff analogous to that which was present in the "only voters pay taxes" case explored in chapter 7.

For example, voters that favor universal suffrage prefer suffrage qualifications that are more inclusive (lower) than those which optimize their fiscal package. However, as long as personal interests in consumption and government services are non-trivial, such voters nonetheless prefer qualifications that achieve *less* than universal suffrage. Extending suffrage produces marginal benefits from greater conformity with the voter's own social norms, but also a marginal cost insofar as taxes and government service levels shift away from more preferred levels.

The optimal suffrage rule extends suffrage beyond that favored by an otherwise similar pragmatist, but only to the point where marginal benefits from broader suffrage equals its marginal fiscal costs. This is not hypocrisy. It simply reflects the fact that for such persons universal suffrage is one of many goals. In equilibrium, the current median voter's ideal suffrage criteria are in place,  $T^{L*} = T^L$ , and  $T^{K*} = T^K$ , and the actual extent of suffrage is also ideal  $S = S(T^{L*}, T^{K*})$ .

Note, however, that when a universal suffrage norm is widespread among voters, an equilibrium of this sort may not exist. Rather, a slippery slope may exist. Each successive median voter may want to expand suffrage a bit, to include a few more persons in order to advance their theory of the good society. A series of suffrage reforms in the direction of universal suffrage would be adopted until a median voter is reached who considers the existing rules to be optimal, which in this case may require universal suffrage or universal adult suffrage.

Of course, any median voter who recognized the possibility of a slippery slope, and preferred the fiscal-suffrage law combination of the status quo to that associated with universal suffrage, might simply accept the status quo rather than press for his (or her) preferred suffrage rule. The slippery slope provides an additional basis for institutional conservatism. This tends to make the slope toward democracy “sticky” rather than “slippery” if voters are forward looking—especially in settings in which fiscal policies under universal suffrage have never been observed.

### *Normative Support for Limited Suffrage*

Universal suffrage, however, is not the only possible normative theory of suffrage, and it was not until the twentieth century that very inclusive suffrage norms became widespread among voters in the West. Prior to the twentieth century, it was more widely believed that all “qualified” persons should be entitled to vote. The qualifications thought necessary varied among persons, but generally included various attributes that tended to increase the independence and quality of one's votes: education, wealth, experience, residency. Here it bears noting that most persons in the West would be opposed to extending the right to vote to 2 year olds and to persons living on other continents.

19th century arguments against universal suffrage parallel in many ways contemporary arguments against extending the vote to children. Children are not wise enough, nor educated enough to cast meaningful votes. We tend to favor universal adult suffrage rather than universal suffrage per se.

Qualification-based theories of suffrage imply that all those who are properly qualified should be entitled to vote, but no others. Such privilege-based theories allow normative aims to vary significantly among voters (and nonvoters). Merit-based normative theories also allow the possibility that norms may shift through time, as “merit thresholds” are revised in light of experience and shifts in ideology

Analyzing the effects of qualification-based theories of suffrage on the suffrage preferences of voters requires the normative theory to be modeled more explicitly than was necessary for the universal suffrage norm. Suppose that a voter’s ideal suffrage level is  $S^* = s(T^{L*}, T^{K*})$ , where  $T^{L*}$  and  $T^{K*}$  are the tax payments from labor or capital income that indicate sufficient independence, to cast a “meaningful” vote. Normative goals are advanced when the difference between the real and the ideal thresholds diminish. The normative advantages of a more perfect suffrage law can be characterized as  $v = n(|S^* - s(T^L, T^K)|)$  with  $v_{|S^* - S|} < 0$ . The effect of such normative theories on suffrage can be modeled by replacing function  $s$  with function  $n$  in the equation 8.1.

The first order conditions for a voter’s optimal suffrage law are similar to 8.2 and 8.3.

$$U_{TL} = [U_X (-C_G) Y_W / Y - U_G] G^*_{TL} + U_S v_{TL} = 0 \quad (8.6)$$

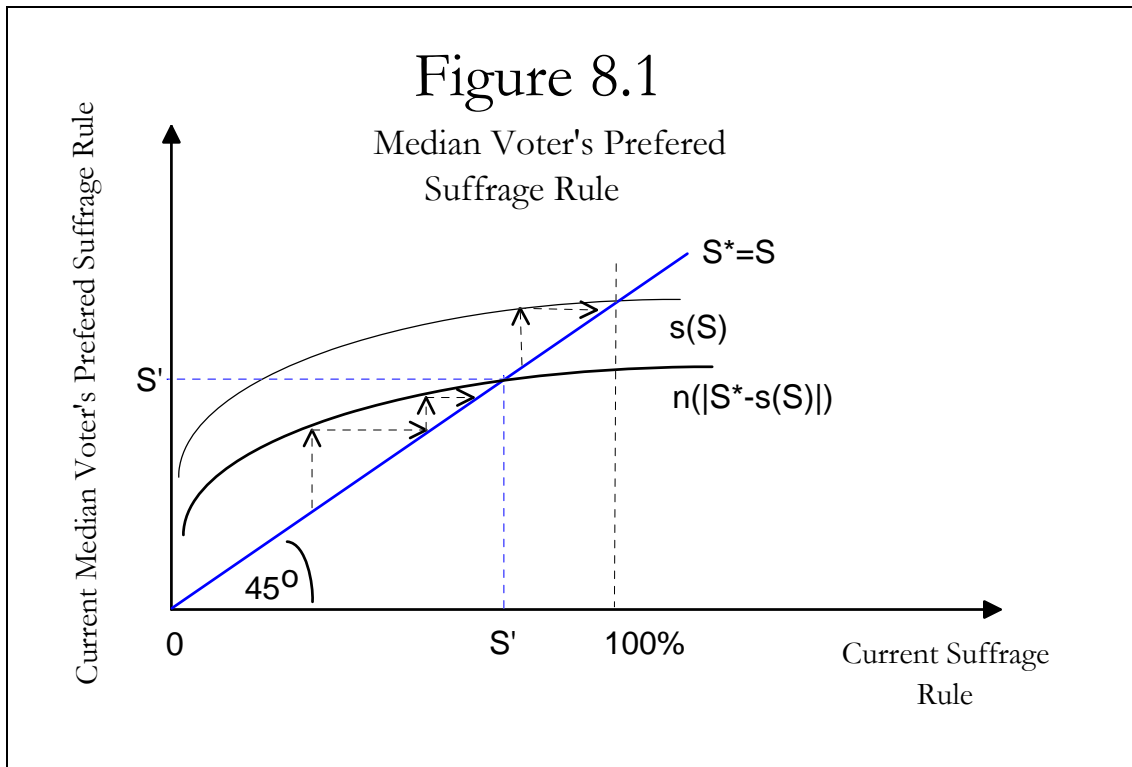
$$U_{TK} = [U_X (-C_G) Y_W / Y - U_G] G^*_{TK} + U_S v_{TK} = 0 \quad (8.7)$$

The effects of qualification-based suffrage norms on voter preferences, however, are less clear cut than a universal suffrage norm, because the tradeoffs depend on whether the existing laws are more or less inclusive than the normatively ideal suffrage law. Some persons may now favor laws that are more inclusive than they consider “ideal,” because including additional voters advance other policy interests.

Under a qualification-based theory of suffrage, as opposed to universal suffrage, stable suffrage law does not require that the median voter be a pragmatist or concerned about a slippery slope. A stable suffrage law under a qualification-based norm occurs when the existing suffrage law is consistent with that voter’s theory  $S=S^*$ . At the equilibrium suffrage level, the marginal utility of further suffrage reform falls to zero,  $U_S S_{TL} = 0$  and  $U_S S_{TK} = 0$ , and the current median voter’s ideal suffrage law,  $S^*$ , is the law of the land. In this sense, it can be said that the median voter is a

normative voter in equilibrium, because the existing laws exactly satisfies his or her normative theory of suffrage.

Figure 8.1 illustrates the equilibrium pattern of suffrage that tends to emerge when either universal or qualification-based suffrage norms are widely accepted by those eligible to vote. The first,  $s(S)$ , depicts a universal suffrage norm, which tends to produce universal suffrage, a corner solution. The second,  $n(|S^*-S|)$ , depicts an interior solution of the sort associated with merit-based theories of suffrage. It is interesting to note that a series of myopic suffrage reforms produces a series of discrete steps toward the equilibrium states, rather than a series of infinitesimal adjustments or great leaps, except in the neighborhood of the suffrage law equilibrium.<sup>63</sup>



Other functional forms are, of course, possible according to the normative theories employed and the distribution of those theories. There may be, for example, more than one equilibrium (fixed point) set of qualifications for suffrage.

<sup>63</sup> The extent of suffrage as a percentage of the citizenry is always bounded at 100 percent. Consequently, the continuity of functions  $s$  and  $n$  are sufficient to assure the existence of a fixed point. Note that the fixed points characterize equilibrium levels of suffrage; however, as noted above, in many cases, the fixed point will lie along the upper or lower bounds of  $S$ .

### *Absence of an Income Effect on Equilibrium Suffrage Laws*

At every suffrage-law equilibrium in figure 8.1, the marginal utility of changing suffrage laws is zero, which implies that changes in the marginal utility of other goods and services do not affect the marginal rate of substitution between those goods and suffrage. (Recall that marginal rates of substitution can be expressed as a ratio of marginal utilities and that zero equals zero.) When the median voter's suffrage norm is the actual law, changes in the median voter's income *will not* induce the present median voter to change the existing suffrage laws.

At a suffrage law equilibrium, the present median voter remains entirely content with the existing pattern of law, whether he or she is motivated entirely by pecuniary interests or takes account of ideological ones as well. Economic growth and taste changes can affect the rules governing suffrage by affecting the marginal rate of substitution between suffrage and other desired services *only at points away from the normative equilibrium*, at which the marginal utility of suffrage reform is not zero.

Changes in the median voter's merit-based suffrage norms, however, can induce reforms by changing the equilibrium, but without necessarily leading to universal suffrage.

### **D. Ideological Groups, Persuasive Campaigns, and the Expansion of Suffrage**

Changes in social norms may, in principle, emerge idiosyncratically as individuals independently revise their norms in light of unique personal experiences, inspiration, or analysis. Alternatively, changes in norms may reflect events that affect a broad cross section of voters. New evidence may undermine some preexisting normative theories, while supporting others. A change in economic or political circumstances may favor persons with particular norms over others, which may induce others to revise their normative rules of thumb to better "fit the times." A new very persuasive book may be published that promotes a particular normative theory and/or challenges a widely held theory.

Norms may also change systematically when organization conduct persuasive campaigns. Campaigns may, for example, suggest that more persons are qualified to vote than previously thought, or that fewer are. In general, persuasive campaigns operate by subsidizing the production and dissemination of information that "demonstrates" the merits of their preferred reforms or shift in norms. Interest groups sponsor or write editorials, pamphlets, and books; they organize public addresses and meetings where information can be easily provided, and subsidize other organizations

and persons that can do so. Persuasive campaigns are educational, in the sense that they change the knowledge base of voters and/or high officials, which changes relevant predictions about future events, assessments of the relative merits of alternative policies, or change the norms used to judge the relative merits of alternative policy proposals.

Persuasive campaigns induce suffrage law reforms, whenever they can change the suffrage norms of the median member of parliament. They may also change the expected policy consequences associated with suffrage reform. To affect suffrage law, such campaigns would require changing the norms of a very broad cross section of voters (and nobles) in the context of the early nineteenth century. Nonetheless, the possibility of influencing day-to-day policy and constitutional decisions together with the effects that such reforms have on private economic and ideological interests creates incentives for those with interests at stake to influence the course of reform. Every country in the West that liberalized its suffrage laws did so after long campaigns by groups organized to promote suffrage expansion inside and outside government.

The advantages of scale and coordination imply that organized groups are often able to do so more effectively than individuals. With such organizational advantages in mind, the leaders of existing organizations may create special divisions to engage in a variety of lobbying activities for the organization (firms, unions, sporting clubs, ideological interest groups, etc.). *Formeteurs* may also create new organizations with the aim of influencing particular public policies.

### *A Model of Contributions to Suffrage Groups*

The public choice literature implies that investments in lobbying enterprises reflect the incentives of those who expect to benefit from their activities.

The relationship between suffrage norms and support for suffrage groups can be analyzed with a minor extension of the model developed above. When election laws are stable, the current pivotal member of parliament is completely satisfied with the existing suffrage laws, so that  $S^{v*} = s(T^{l*}, T^K)$ , as noted above. Consequently, the pivotal member and his or her supporters have no interest in supporting suffrage groups, because they are completely satisfied with the status quo. However, the pivotal member of parliament is not the only person that is relevant when interest groups can influence voter or MP choices. Those who favor more liberal election laws have an interest in supporting suffrage groups, if there is a chance that suffrage groups can persuade the median voter to change his suffrage norm. Those who favor more restrictive rules may similarly donate to groups lobbying for a more aristocratic electorate. Support for such groups provide individuals with a



method of increasing their (expected) utility over the status quo as long as such groups have a reasonable chance of affecting suffrage policies.

Consider the case in which new suffrage level  $S' > S_v^*$  is supported by a suffrage group. Individual supporters make donations,  $D_i$ , to the suffrage group in order to maximize their expected utility:

$$U_i^e = (1-p(\Sigma D_j)) u(X_v - D_i, G^v, n(|S_i^* - S^{v*}|)) \\ + p(\Sigma D_i) u(X_v - D_i, G_v, n(|S_i^* - S'|)) \quad (8.8)$$

where  $P = p(\Sigma D_j)$  is the probabilistic success function of the relevant suffrage group's efforts to change suffrage norms,  $D_i$  is citizen  $i$ 's donation, and  $\Sigma D_j$  is the total of all individual donations. Under the usual Nash assumptions, the expected utility-maximizing donation satisfies:

$$-P_D U^0 + (1-P)(-U^0_x) + P_D U' + P(-U'_x) = 0$$

which implies that  $D_i^*$  approximately satisfies:

$$P_D (U' - U^0) - U_x = 0 \quad (8.9)$$

Equation 8.9 implies that an individual's contributions to the suffrage group can be written as:

$$D_i^* = d(Y_i, S', S_v^*, \Sigma D_j, Y, Z) \quad (8.10)$$

with

$$D_i^*_{Y_i} = [P_D (1-t) (U'_x - U^0_x) - (1-t)U_{xx}] / -[(P_{DD} (U' - U^0) + P_D(U^0_x - U'_x) + U_{xx})] > 0 \\ (given U'_x - U^0_x > 0) \quad (8.11)$$

and

$$D_i^*_{\Sigma D_j} = [P_{DD} (U' - U^0)] / -[(P_{DD} (U' - U^0) + P_D(U^0_x - U'_x) + U_{xx})] > 0 \\ (given P_{DD} > 0) \quad (8.12)$$

Individual contributions increase as personal income increases and with the overall level of contributions, if persuasive campaigns exhibit constant or increasing returns. Such comparative statics are commonplace in interest group models of lobbying, although most such models do not usually account for ideological interests (Congleton 1991a, Olson 1965).

The probability of suffrage reform increases as supporter income and the effectiveness of suffrage organizations increase, other things being equal, because the probability that the current

pivotal voter(s) is persuaded by the suffrage groups to adopt  $S'$  as his (her) suffrage norm, rather than  $S^*$ , is increased by contributions,  $P^* = p(\sum D_j^*)$ . Persuasion and lobbying activities become more effective as more resources are devoted to them, other things being equal.

### *Industrialization and the Effectiveness of Suffrage Groups*

Other things, however, are not always equal. Reductions in censorship, technological innovation, and industrialization in the late eighteenth and nineteenth centuries made effective suffrage groups more likely to emerge than had been the case in previous centuries. Industrialization alters the manner in which economic resources are employed throughout the economy by increasing capital intensity and specialization. Industrialization stimulates technological innovation and tends to increase the average size of commercial organizations. Industrialization thereby changes the relative cost and benefits of organizing politically active interest groups, many of which may have an interest in suffrage and other reforms.

The same improvements in coordination, communication, and transport that allow economic entrepreneurs to assemble and manage large numbers of employees in many locations also allow political entrepreneurs to assemble and coordinate the political activities of large numbers of individuals in many locations. The costs of organizing interest groups are further reduced by the urbanization associated with industrialization.<sup>64</sup> Potential group members are also accustomed to participation in joint enterprises in which rules are to be followed and deference to leaders is routine. Industrialization also tends to increase the incomes of many persons that favor political liberalization, including broader suffrage, and an increase in income among those with an interest in suffrage reform tends to produce better financed and more effective suffrage groups. Both employees and employers often share common economic interests and in many cases ideological interests as well, as often was the case with respect to trade and suffrage liberalization in the nineteenth century.

Industrialization, however, increases the probability that suffrage-expanding reforms will be adopted only if the resources flowing to prosuffrage groups increase relative to those flowing to anti-suffrage groups. This tended to be true in the West during much of the nineteenth century, as developed in Part II of the book. For example in England, industrial centers were underrepresented in Parliament, which made it difficult to press for economic policy reforms without first pressing for

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<sup>64</sup> Locating firms close to one another tends to reduce the cost of transporting intermediate goods and providing specialized services to large enterprises and their employees.

electoral reform. The effects of industrialization on interest group activities thus tended to reinforce liberal tides in other policy areas as well, such as education reform, reductions in internal and external trade barriers, and reapportionment.

The number of politically active groups increased throughout the nineteenth century. Many late nineteenth century, politically-active, interest groups had relatively narrow policy agendas in education, trade, public health, trade, debt, and labor law. Such groups often had overlapping supporters and members, and many also supported modest (or radical) suffrage expansion. Consistent with the model developed above, their memberships were not drawn entirely from the unenfranchised. They were often financed by and led by those who could already vote, but who had normative interests in policy reforms.<sup>65</sup>

Reductions in organization costs allows a broad range of new interest groups to be formed and a broad range of persuasive campaigns to be undertaken. The new groups will include supporters and opponents of reform, and the public policy debates may be quite intense, as opponents attempted to attract the attention of officeholders, voters, newspapers, and the public at large. However, persuasive campaigns inside and outside government are not the only methods used by the interest groups that attempted to influence public policy.

### **E. Emergence of Political Parties and Partisan Interests in Suffrage Reform**

When prosuffrage movements succeed, politics gradually becomes depersonalized in the sense that fewer voters personally know the candidates running for office. Voter assessments of candidates, consequently, become more and more indirect, as secondary sources of information substitute for direct knowledge. News accounts, pamphlets, the recommendations of knowledgeable persons, and gossip, thus, increasingly determine voter assessments of the relative merits of candidates. These indirect sources of news can be manipulated (and augmented), which allows candidates and groups to conduct “campaigns” for office, rather than passively away election results once nominated.

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<sup>65</sup> Suffrage movements throughout Europe during the nineteenth century became increasingly strong during the course of the century. As noted below in part II of the book, these groups were often supported by the liberal and labor movements, each of which attempted to have suffrage extended to their members. In this manner, ideology and narrow self-interest motivated politically active interest groups both supported suffrage reform; however, their success was substantially dependent on “ideological” effects on those with the power to reform suffrage laws. It was the persons that could vote and their elected representatives who adopted suffrage reform.

Candidate efforts to engage in persuasive campaigns exhibit the many of the same economies of scale that other persuasive campaigns do. And, those same economies of scale imply that a single organization can organize campaigns for several candidates at a lower average cost than for a single candidate. Average campaign costs are further reduced when the candidates supported have similar policy goals and sponsors. Similar arguments and speakers can be used to promote several candidates.<sup>66</sup> It is thus sensible for candidates or other formateurs to form organizations to orchestrate the political campaigns of candidates with similar policy agendas.

Through time such political clubs may gain a reputation for supporting talented candidates with particular policy aims, which further reduces the cost of informing voters about candidates.<sup>67</sup> Campaign organizations may also engage in a variety of loyalty building and promotion activities among voters, such as organizing parties and festivals at which candidates or their supporter's speak, particularly at or near election days. Simply being a participant at such parties provides voters with useful information about the candidates. Indeed, parties and party affiliation can be electorally more important than the candidates themselves in settings in which electoral politics becomes a mass marketing affair. Unaffiliated candidates face much higher informational barriers to mounting a successful campaign and so are much less likely to enter or succeed in contests against organized party slates.

To the extent that the pool of "partisan" voters can be increased through suffrage reform, the political parties that expect to profit (or lose) from those voters have *organizational* reasons to support (or oppose) suffrage expansion in addition to the fiscal and ideological ones mentioned for voters. Suffrage reform can sometimes create a relatively stronger base of future electoral support.

During the early and mid-nineteenth century, liberal parties generally pressed for suffrage expansion, while conservative parties defended the medieval order, with its 5-10% suffrage, noble chambers, aristocracy, and state church. As suffrage reform became more likely because of ideological and electoral trends, conservative parties also became increasingly prosuffrage. Indeed, "conservatives" would sometimes initiate suffrage expansion in order to control the details of the

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<sup>66</sup> There are other advantage in creating and joining organizations that promote candidates with similar ideological positions. Like-minded politicians may enjoy each other's company, may cooperate to get legislation of mutual interest adopted, and therefore, be inclined to help each other be elected to office.

<sup>67</sup> The joint reputation of past members of the club, and the various networks of club members significantly reduce the difficulty and cost of having new candidates taken seriously by voters. Just as there can be "guilt by association," there is also "reflected glory" as present party members gain some secondary reputation from great reforms of the past.

reform. In such cases, partisan interests clearly trumped ideological ones. Towards the end of the nineteenth century, liberals were joined by social democrats in their efforts to expand suffrage. The fact that a political party's slate of recommended candidates must be elected to affect legislation means that parties must be sensitive to changing voter interests *and also to those of nonvoters who may one day be able to cast votes.*

The influence of organized "political clubs" (parties or factions) tends to grow as the number of votes required to win office increases and as parliamentary majorities become an increasingly important determinant of public policy.

## **F. Specialization, Labor Unions, and Suffrage Reform**

Another manner in which organizations may influence policy outcomes involves direct trades of money or support for policy changes. For example, completely legal bribe-like transactions can be arranged. A high-paying part-time jobs may be provided for high officials who favor the "proper" policies. Such jobs were offered by kings and industrial interest groups during the eighteenth and nineteenth centuries. Illegal bribes and threats can also be used, although only at the margins, insofar as laws against such deals were actively enforced. These techniques extend back to medieval times, as noted above, and the emergence of new wealthy persons and organizations increased the number of the persons in positions to offer such trades during the nineteenth century.

Conversely, one may threaten to withhold support or reduce someone's income in exchange for support on particular policies. When the threat is violence, this bargaining technique (extortion) is illegal; however, many similar threats are perfectly legal. As industrialization takes place, specialization increases, and personal income becomes increasingly dependent on the availability of other complementary resources and on the presence of a more or less reliable demand for their employer's outputs. Farmers need seeds and farm animals. Farmers that ship their produce to market via railroads need, railroad engineers, efficient steam engines, track, coal, water, and steel as much as they need seeds and farm animals. The more specialized production becomes, the more interdependent are the incomes of persons engaged in production. That interdependency allows organized groups to threaten to reduce the incomes of those outside the group by collectively withholding their inputs (labor or capital) from the market, as with boycotts, strikes, and strike threats.

*Industrialization and the Effectiveness of Strike Threats*

Consider the following model of bargaining between the present median voter and a prosuffrage group with a credible strike threat. Recall that the quasi-constitutional rules governing suffrage determine the identity (total income) of the median voter, which along with the available tax base and cost of government services determines the level of government services. In the absence of a strike threat, the median voter under a given electoral set of rules ( $T^L, T^K$ ) realizes after-tax consumption level  $C^* = (1 - C(G^*, Z)/Y) (w(L_M - L_V) + r(K_M - K_V))(2 - \sqrt{2})/2$  and government service level  $G^* = C(L_V, K_V, T^L, T^K, Y, Z)$ . As noted above, at this political equilibrium, the suffrage laws will maximize the welfare of the pivotal voter.<sup>68</sup>

In the usual neoclassical production function, production exhibits constant returns to scale and each factor is paid its full marginal product. In such an economy, a strike threat has fiscal effects only. A group that temporarily withholds their factors of production from the economy suffers a loss in income and nonstrikers suffer a reduction in the tax base, which either causes tax payments to rise for nonstrikers, public services to fall, or some combination of the two. (Recall that  $Y$  is an argument in  $G^*$ .) In an economy in which substantial specialization exists or where there are increasing returns to scale, a group that withholds its factors of production from the economy may also reduce the incomes of nonstrikers by reducing the marginal product of their productive resources. It is difficult to make automobiles without steel, steel without coal, and any of these without labor or transport.

Note that fiscal effects allow the unenfranchised to bargain with the enfranchised for electoral reform. In the absence of franchise reforms, the present pivotal voter will face higher taxes, lower government services, and reduced private consumption. In effect, strike threats place the median voter in a situation similar to that analyzed in chapter 7 in which the tax base is partly determined by suffrage levels. The pivotal voter will be willing to vote for the suffrage expansion requested by the

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<sup>68</sup> Although satisfactory to the pivotal member of parliament, the existing suffrage laws are not necessarily Pareto efficient. For example, unrealized gains from political exchange may exist in equilibrium if transactions costs are significant. The unenfranchised might well be willing to pay enough to induce the median voter to change suffrage rules, but may be unable to raise the money to deliver the necessary side payment to alter the “median voter’s” position on the suffrage (recall equations 9.1 and 9.2).

If strikes are easier to arrange than side payments, the constitutional bargain achieved with a strike threat could generate a Pareto-efficient constitution, although it is unlikely to be one that is Pareto superior to the initial constitutional setting.

strikers whenever the expected losses from more frequent strikes exceed those associated with extending the franchise.

If the present median voter's tradeoff between suffrage and fiscal stability is known beforehand, organized labor can select the probability of strikes that elicits the desired constitutional response, for example, extending the vote to union members, but perhaps not to peasants, persons on relief, women, or children. Any constitutional bargain reached, however, depends somewhat on the particular sequence of offers and counteroffers that take place. For example, in the case in which the median voter is able to anticipate or elicit a menu of strike probabilities from the economic interest group (as within a Grossman and Helpman [1996] model), the present median voter will propose the suffrage reform that equates his or her expected marginal gains from increased income and tax-base security with the cost of the less appealing combination of government services that will be adopted by the new median voter.<sup>69</sup>

During the late nineteenth century, labor unions representing unenfranchised blue collar laborers were normally more interested in higher wage rates, improved working conditions, and limiting work weeks than in suffrage extension, although they normally advocated broader suffrage rights along with their main interests. There were a few occasions in the early twentieth century (in Sweden and Belgium) in which strikes played a significant role in negotiations to reduce tax/income thresholds for suffrage rights. Suffrage reforms in such cases are a consequence of fiscal-suffrage bargaining between outsiders and insiders analogous to those discussed in chapters 6 and 7. Similar effects can be generated through output boycotts and threats to migrate to other polities. Any credible threat to reduce tax revenues or the income of fellow taxpayers can have an effect on public policy and constitutional bargaining because it changes the tradeoffs among policy options.

Large scale boycotts or strike threats, however, are not easy to organize and, as true of many interest group activities, may be suppressed by those whose interests are advanced by the status quo. Suppression, however, is more difficult in highly industrialized settings, because of the same economic interdependency that makes such threats effective. There are various "choke points" at which a relatively small organization can have large effects on the economy as a whole, as with rail road strikes in the late nineteenth century.

It bears noting that the present analysis is not class based, but rather interest-group and production based. Many economic groups that can be organized within a polity do not have similar

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<sup>69</sup> Promises to reduce the probability of striking in the future are somewhat more creditable for radical suffrage reforms than for minor reforms. Once universal suffrage is obtained ( $T^L = T^K = 0$ ), no further increase in suffrage can be secured via strike threat.

incomes, as is true of women, consumers, environmentalists, farmers, steel mill owners, and laborers in different industries. There are several contemporary non-class-based economic interest groups that have considerable influence over contemporary public policy including the American Association of Retired Persons (AARP) and the Organization of Petroleum Exporting Countries (OPEC). In the case of interest here, however, the constitutional interests of *unenfranchised men* were largely a result of their similar incomes, because the electoral rules that strikers wish to change are income or class based. Wealth- and income-based rules for suffrage discriminate against those who have low income and wealth, which is, of course, often used by sociologists as a method of defining socioeconomic class.

In the nineteenth century and most earlier periods, income, wealth, religion, and sex had all been used to determine what might be called one's civil status.

### **G. Conclusions: Western Democracy as a Consequence of Constitutional Reform**

We now have three series of models that together provide explanations for a largely peaceful and gradual emergence of parliamentary democracy. The first accounts for the emergence of policymaking institutions and for the widespread use of the king and council template. The second demonstrates that when applied to territorial governance, the king and council template provides a continuum of governmental types and distributions of policy making authority. Within that template, kings may gradually bargain away their authority in exchange for tax revenues and other support. The third suggests that the basis for membership in the parliament tends to be somewhat less flexible, but nonetheless demonstrates that suffrage can be gradually expanded by parliament when suffrage norms change or interest groups press for liberal economic and political reforms. Rules for selecting members of parliament and kings may also be adjusted through time.

The analysis suggests that these are substantially, although not entirely, separate processes. Many of the "shocks" that can produce new gains to organization will not produce constitutional exchange between the king and council. Many of the "shocks" that produce constitutional gains to exchange between the king and council will fail to produce parliamentary support for reforms of the rules through which members of parliament are chosen. On the other hand, there are changes, such as shifts in widely-held normative theories, that can produce support for suffrage expansion, new opportunities to shift authority from the king to the parliament, and encourage the formation of new nongovernmental organizations.



The constitutional bargaining models of chapters 5 and 6 imply that the politics of constitutional reform is in many ways similar to the politics of ordinary legislation. New gains to trade tend to emerge when a king's need for new taxes is greater than his wish for control over particular areas of public policy, and parliament's interest in additional authority in those areas is greater than the opportunity cost of additional taxes. Similar gains to trade also emerge when the theories of governance of the king and pivotal members of parliament shift in the same direction. Chapter 7 and 8 demonstrate that similar bargains over suffrage tend to be less common, because non-voters lack political property rights that can be traded to those who can vote. The median voter under a given suffrage law normally want to remain the median voter. This allows "him" to obtain the best fiscal package that is possible (given the authority of the parliament relative to the king). Suffrage law and other selection procedures, thus, tend to be more stable through time than the distribution of policymaking authority between a king and council or between a king and parliament.

Nonetheless, there are occasions at which members of parliament will have an interest in changing suffrage laws. Three such cases were explored in chapter 8. The first involved changes in the normative theories of governance that can induce the median member of parliament to favor electoral reform. These are not changes in "tastes" in the sense used by economists, but changes in the theories used to understand and assess the relative merits of alternative reforms. Such changes can occur spontaneously as theories are adjusted at various margins to account for new possibilities or new evidence. They may also be induced through organized persuasive campaigns of interest groups.

The second reason that suffrage laws might be reformed involves changes in the organizational interests of the political parties. Political parties that expect to obtain the electoral support of new voters, or that hoped to reduce the increase of their rival, will often press for suffrage reform for entirely pragmatic reasons. The third involve constitutional bargains analogous to trades between kings and parliaments with veto power over taxes. An organized interest group that can engineer an "input boycott" can reduce tax revenues for persons already entitled to vote and thereby reduce the value of the present fiscal package. Expanding suffrage in this case may improve the fiscal package relative to that associated with a long strike or a long series of strikes. Similarly, a coalition within parliament that favors suffrage expansion for ideological or pragmatic reasons may provide support for other policies in exchange for support on suffrage reform.

Liberalism and industrialization tend to be associated under these mechanisms, because the liberal reform agenda tended to advance the economic interests of industrialists and many of their

employees. A liberal trend can be produced when industrialization produces new support for politically-active, liberal, interest groups. Industrialization tends to gradually increase the income of likely supporters. Such trends may be reinforced by technological advances associated with industrialization. Interest groups become easier to organize as communication and transportation costs fall and as techniques for managing large groups improve through time. The urbanization associated with industrialization further reduce organizational costs at the same time that it produces new interests in policy reform, many of which involve local services rather than constitutional issues.

### *Absence of Revolutionary Threats*

The intensity of some debates and associated “revolutionary rhetoric,” over constitutional reform is not usually evidence of revolutionary organizations or threats, but simply evidence of the importance of particular reforms for politically active organizations and their supporters. What Tilly (2004) calls contentious politics is a predictable consequence of disagreements over reforms in which the stakes are high. Revolutionary rhetoric was used by organizers throughout the period of interest, but few true revolutions were in the offing. Such rhetoric clearly helped motivate members of pro-reform interest groups, but it was only a subset of the factors that produced the long series of reforms leading to Western democracy.<sup>70</sup> It takes more than rhetoric for reforms to be adopted.

For the most part, as demonstrated in part II, Western democracy emerged gradually over the course of a century or so, as a consequence of a series of fairly small reforms. Revolutionary threats were rarely very important, although public demonstrations of support were often associated with reforms. It bears noting, for example, the last and largest group enfranchised were woman, who lacked organizations that could easily disrupt economic activity or provide a credible revolutionary threat, but who organized peaceful demonstrations and who were increasingly considered able to cast an independent and sensible vote. Similar expansions of suffrage took place among all the Western democracies in the years before and after World War I. Women were enfranchised by persuading male voters to extend the franchise the them, rather than by overthrowing a dictatorial regime through force of arms.

Chapters 7 and 8 note that many of the same conclusions hold concerning suffrage, although the impulse for suffrage reform tends to differ somewhat from that of parliamentary reform. The reforms of suffrage is also choice along a constitutional continuum, rather than a choice between

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<sup>70</sup> As noted above and in chapter 19, the direction of causality does not appear to be unidirectional. As suffrage was extended in northern Europe, additional economic liberalization tended to take place as well.

“democracy” and “dictatorship,” as is often claimed. Suffrage can become more and more inclusive and still not be universal. Again small changes are more likely to be adopted than large ones. These tendencies are reinforced by the constitutional conservatism that a factor in most organizational reforms. Every reform can produce surprise results; the smaller the reform, the less likely unpleasant surprises are to be the smaller they tend to be. Gradual, but discrete, reforms are implications of the analysis. Because shifts in authority are adopted through constitutional means, the models suggests that the reforms will tend to be relatively small in magnitude and that a relatively small number of reforms is likely to be adopted at a given time.

Chapters 7 and 8 imply that democracy does not arise, because it is a “superior or normal” good in the usual economic sense. The current median voter of a narrow electorate is normally quite content with the election laws that made him or her pivotal, regardless of how restrictive they are, or how high their income is. Rather, the analysis suggests that democracy may be indirectly produced by shifts in the theory of government and an increase in the relative effectiveness of prosuffrage interest groups.

It bears noting that liberal ideas and industrialization are not the only factors that can produce pressures for political and economic liberalization within the models developed in part I. For example, the exit options of citizens and yardstick competition may encourage liberalization. The exit options of labor and capital can induce liberal economic reforms. Policies that are demonstrated to increase tax revenues are of interest to most governments. Strategies for increasing parliamentary control and organizing more effective liberal interest groups are of interest to all members of parliament and all potential formateurs of interest groups. The exit options of large blocks of voter-citizens may encourage political liberalization, when public policies induce sufficient emigration. Knowledge of the constitutional reforms of other governments were widely known and copied among the countries that liberalized in the late nineteenth century.

Such factors clearly played a role in the emergence of relatively liberal economic and political institutions in the seventeenth century in both the Netherlands and in the British colonies that eventually became the United States of America, as developed below in chapters 15 and 18. Both labor and capital could choose among provinces and colonies. They tended to be attracted to those with more open political and economic systems. In this manner, competition for productive resources encouraged substantial economic and political liberalization among the Dutch provincial and American colonial governments.

In those cases as well, successful liberalizations tended to be accomplished through gradual—piecewise—reform, rather than revolutionary—whole cloth—reinventions of governance. No sudden enormous breaks with the past were necessary for democracy to emerge from medieval parliamentary regimes in Western Europe and Japan, nor were class consciousness and civil war necessary preconditions for liberal reform.

*Empirical Support Is Needed*

The models of part I provide a schema for thinking about transitions to Western democracy that allows the possibility that a long series of reforms could have gradually produced Western democracy. Part I has included several illustrating examples from European history that suggest that the models can account in broad terms for some of the institutions and reforms that led to parliamentary democracy. These demonstrate that the analysis has at least some relevance, but are not enough to prove the models are broadly applicable. With the pursuit of more evidence and applications in mind, part II provides a series of much more detailed constitutional narratives written with the implications of the models of part I in mind, and with a focus on constitutional negotiations and reforms.