

April 19, 2024

Dear Friends:

The following paper lays out the arguments in *Leviathan Denied: Rules, Organizations, Governments and the Institutional Origins of Modern Democratic Capitalisms*. It is a blend of a paper and several chapters. It is an attempt to satisfy the “book-in-progress” nature of the seminar.

I apologize for the length. I took the “book-in-progress” charge seriously. The opening section is called “The Big Picture.” It attempts, in five pages, to lay out the conceptual arguments in the book, without examples and without any history.

The remainder of the paper, although it is really more than a paper, develops the conceptual ideas, briefly describes the historical argument, and presents the bare bones of the empirical evidence. Even the full treatment of the empirical evidence is only suggestive, as the primary purpose of the book is to lay out the conceptual framework. It just turns out that the framework has interesting and suggestive implications for the emergence of the first modern developed democratic capitalisms in the late 19<sup>th</sup> and early 20<sup>th</sup> century

This is an attempt to bring together a complete and integrated draft of the argument, and the argument has several moving pieces. Unfortunately there is some repetition that I have not yet ironed, or edited, out. I hope it isn’t as bad as it looks when you see the page count.

I look forward to your comments.

Best, John

*Leviathan Denied: Rules, Organizations, Governments and the Institutional origins of Modern Democratic Capitalism*

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April 19, 2024

In the middle of the 19<sup>th</sup> century the course of human history changed. A long series of technological innovations reached an accelerating tipping point into sustained improvement that transformed our relationship to the natural world, increased the material standard of living (economic growth), and led eventually to the current environmental crisis. A new series of institutional changes in the organization of societies' political economies led, for the first time in recorded history, to democracies where leaders of large populations were chosen by open elections. The rules governing the economy allowed the free allocation of resources among a wide range of competing uses and unfettered ability for citizens to form organizations that the government would recognize and support. The societies that moved fastest and furthest on these dimensions were a small group of western European nations and the colonial "neo-Europes:" United States, Canada, Australia, and New Zealand. With a few additions they constitute the rich and developed nations of the early 21<sup>st</sup> century.

"Modern" societies are societies where citizens are free to associate and form organizations, where government leaders are selected through free elections in which adult citizens are able to participate without coercion or influence, where basic civil and political rights are available to all citizens, and laws in general apply the same to everyone and are enforced in an unbiased way. Historically, there were no modern societies until the middle of the 19<sup>th</sup> century, and by 1900 only a dozen or so modern societies existed. A list in 1910 would

include Britain, France, the Netherlands, Belgium, Switzerland, Sweden, Norway, Denmark, the United States, Canada, Australia, and New Zealand. Germany was on the periphery of a modern society, but had not met the conditions in 1910 and would fall back in the 1920s and 1930s, as would Italy, Austria, Spain, and Portugal. All seventeen countries experimented with some form of democracy after 1850. But only the countries with impersonal rules kept their democracies in the interwar years. Today perhaps two dozen societies are modern, but this book will focus on the changes in 19<sup>th</sup> century institutions that brought about transitions to modernity and all of those transitions were in Europe or in the neo-Europes. The 1920s and a 1930s are a simple test of why impersonal rules are a necessary element of modern democratic capitalisms.

The book investigates the institutional origins of the transitions to modern democratic capitalisms, or the failure to transition, in the early 20<sup>th</sup> century. In a nutshell, institutions are the rules of the game. They are the rules societies adopt to coordinate relationships between individuals, between individuals and organizations, and between organizations. Institutions affect every aspect of social life, including both economics and politics. Institutions facilitate coordination between individuals. Much of the coordination is done through the coordination of individuals within organizations, where organizations are groups of people who agree to use rules to govern some of their relationships to each other. Rules are always the result of agreements between people, even though many rules apply to people who did not consent or agree to the creation of the rule. The core of the book is rules and organizations, and by extension governments.

## 1. *The Big Picture*

Organizations are groups of people who adopt rules to govern some of their relationships. They do so to increase the value of those relationships by facilitating coordination. Unfortunately, no rules work well in all circumstances and, in the wrong circumstances, following a rule may decrease the value of relationships. In those circumstances the rule will be ignored, amended, or eliminated. Since the coordinating power of a rule depends on the expectations that it will be followed, if relationships are more important than rules, no one can expect that a rule will be followed in all circumstances. Relationships will make agreed upon rules less effective coordinating devices than they might otherwise be. This is the *fundamental tension between rules and relationships*. All organizations must deal with the fundamental tension.

One common way of dealing with the fundamental tension is for two or more organizations to reach an agreement to enforce rules for one another. If organization A enforces a rule for organization B, and organization A is insulated from the relationships that affect the enforcement of the rule in organization B, the rules in organization B may become more predictable and more effectively coordinate relationships in organization B. An *external rule* is a rule used one organization but enforced in another organization. Most laws that governments enforce are external rules: they are rules used by other organizations. Governments are an example of *coordinating organizations*: organizations that enforce rules for other organizations. External rules are ubiquitous in human societies. All third party enforced rules are external rules, and third party enforcement is a feature of all human societies from hunter gatherer societies up to modern nation states.

Two other dimensions of external rules matter to their effectiveness. We usually think of rules as *prescriptive*: the rule specifies behavior to be followed and, often, penalties for not following the behavior. If a coordinating organization enforces a prescriptive rule, all the other organizations that use that rule have to follow the prescription. The opposite of a prescriptive rule on this dimension is a *default rule*. Default rules can be enforced, but do not have to be followed. An external default rule will be enforced by a coordinating organization, but only if organizations or individuals with the ability to *access the rule* ask that the rule be enforced. Coordinating organizations enforce default rules, but they do not actively police them. Default rules are outside options for relationships. People and organizations can invoke the default rule when needed, but they do not have to follow it in practice. Default rules make for much more flexible external rules than prescriptive rules. While there are clearly situations in which a coordinating organization enforces prescriptive rules, coordinating organizations often enforce default rules. Default rules enable much more heterogeneous behavior that is, nonetheless, coordinated by a predictable rule.

The predictability of default rules is as important for their coordinating ability as predictability is for prescriptive rules. Most rules in most societies are *identity rules*: rules whose form or enforcement vary according to the social identity of the individuals or organizations to whom the rule is being applied. The opposite form of a rule on this dimension is an *impersonal rule*: a rule that applies equally to all individuals (or usually to a large category of individuals, like citizens). The enforcement of an identity rule depends on the identity of the parties using the rule, and so an identity rule's enforcement is less predictable unless the parties in a relationship are certain of the identities of their counter-parties, and they know how the rule will

apply to different identities. An impersonal rule that applies equally to all citizens only requires that the parties know who is a citizen and who is not. In general, external default rules are more effective coordinating rules if they are impersonal rules than if they are external identity rules.

For reasons that are clear, relationships are more durable through time and thus more valuable, *ceteris paribus*, if the parties in a relationship can see that the other parties all receive rents from being in the relationship. A simple rationality assumption for organizations is that all members of an organization must receive rents from belonging to an organization, else they would leave. This is the *participation constraint*. Rules that create rents often do so because they identify specific rights and responsibilities of particular individuals to other particular individuals, or on the scale of organizations of a particular organization to other particular organizations. Most rules in human societies are inherently identity rules. This reality is often deplored by those who argue that justice and morality demand that rules be impersonal, that they apply equally to everyone.

In *Violence and Social Orders* North, Wallis, and Weingast (NWW) laid out the logic by which most societies attempt to sustain social order. They did not use the term identity rules, but they developed a logic in which powerful organizations, and the “elites” who head them, reach agreements with each other not to fight: to sustain social order. Those agreements are made credible by the fact that different rules create rents for different elites, and the rents the elites receive from belonging to and adhering to the agreement will disappear if the agreement breaks down and elites fight. Identity rules create the rents that sustain social order. They are, as NWW suggested, the natural way societies are organized and so they are called “natural states.” The puzzle then, which NWW recognized but did not solve, is why did a few societies emerge in

the 19<sup>th</sup> century whose governments are capable of creating and enforcing impersonal rules?

Those societies became, and still are, the most politically and economically developed societies in the world.

The earlier argument suggests that a society whose government becomes capable of creating and enforcing impersonal rules on a broad scale would get more organizations, more productive organizations, more heterogeneous organizations (and thus more a more productive economy through specialization), a more innovative economy (more heterogenous organizations doing different things), and more freedom and liberty (as external impersonal default rules enable individuals and organizations to coordinate using rules that they did not have to follow). All of these claims are justified in the book. Those are clearly features of the rich, developed, open access societies of the world today that did not emerge until the middle of the 19<sup>th</sup> century at the earliest.

The emphasis earlier on the fundamental tension may seem to have little to do with how whole societies are ordered, but a moments reflection on the logic of the natural state immediately suggests that as we move up to higher orders of organization in a society the fundamental tension becomes more problematic, not less. At the highest levels of a society what matters for sustaining social order are the relationships between powerful elite organizations, the really dangerous people. If their relationships cannot be coordinated by agreed upon rules, then social order breaks down and, in the worst cases, violence breaks out. As NWW suggest, in almost all societies identity rules are the social arrangement that best establishes social order.

If modern economic development requires governments capable of creating and enforcing a broad range of impersonal rules to realize the gains in productivity, the increase in

the value of relationships discussed above, two questions have to be answered. First, how did some societies first come to adopt impersonal rule provisions or agreements in which more publicly created rules became impersonal. Second, how were governments able to sustain impersonal rules as a stable outcome, given that most societies historically and in the contemporary world cannot sustain them?

The answer lies in the logic of the participation constraint. In most societies there are many organizations contending with each other to influence or control government organizations, often called *factions* in western political theory. A government's primary purposes is to create and enforce external rules and to implement collective agreed decisions about public goods (through taxes, expenditures, and debts). At one extreme when agreements between the factions that are competing for control of or influence over the government, order breaks down and civil war or other forms of internal violence break out. That is the condition of many natural states, even in the world today. At the other extreme are societies where competition for control of and influence over the government is limited to a small number of *consolidated* political parties. Consolidated parties exist in a *party system* in which a small number of durable political party organizations compete repeatedly in open and free elections. The winning party gains more influence over the government, both the administration of government organizations and policy as well as the formation and amendment or agreed upon rules. All of the consolidated parties agree to an impersonal rule provision. In order for parties to become durable, the parties that lose elections must survive past those elections to compete in future elections. To guarantee survival, all the parties must agree to a rule that whatever rules



they create or amend will apply equally to all citizens. That limits (or virtually, but not quite, eliminates) the power of a winning party to harass, suppress, or eliminate the losing parties.

How this process played out was different in every country that adopted impersonal rule provisions in the late 19<sup>th</sup> and early 20<sup>th</sup> century. There is no general history of when societies adopted impersonal rules, and very few narrow histories either. But of all the countries that experimented with democratic reforms in those years, only the societies that adopted impersonal rules along with their democracies were able to sustain their democracies in the 1920s and 1930s. Only the countries with impersonal rule developed consolidated political party systems and were able, for the first time in human history, to limit the fundamental tension sufficiently to be ruled by laws, rather than men.

This book has three major parts. The first examines how we think about institutions as rules and develops a view of institutions as agreed-upon-rules within organizations. The second part uses the emergence of the first developed societies, both economically and politically at the end of the 19<sup>th</sup> and beginning of the 20<sup>th</sup> century, as an illustration of how thinking about institutions as agreed upon rules that are not necessarily followed can help us better understand how societies work. That results in a new explanation of how modern economic, political, and social development got underway. The third part looks at some empirical implications of the story. So while the book is about the emergence of modern societies in the mid 19<sup>th</sup> and early 20<sup>th</sup> century, the framework for the explanation is based on a different way of thinking about institutions as agreed-upon-rules that organizations in a society create, enforce, and utilize to facilitate coordination.

## 2. *What institutions are:*

### 2.1 *Our existing approaches*

This book investigates the institutional origins of the transitions to modern democratic capitalisms, or the failure to transition, in the early 20<sup>th</sup> century. In a nutshell, institutions are the rules of the game. They are the rules societies adopt to coordinate relationships between individuals, between individuals and organizations, and between organizations. Institutions affect every aspect of social life, including both economics and politics. Institutions facilitate coordination between individuals. Much of the coordination is done through the coordination of individuals within organizations, where organizations are groups of people who agree to use rules to govern some of their relationships to each other. Rules are always the result of agreements between people, even though many rules apply to people who did not consent or agree to the creation of the rule.

Coordination can also be facilitated by repeated patterns of behavior or “behavioral norms.”<sup>1</sup> If behavior follows patterns, then our expectations about how others will behave are shaped by our experience of the patterns. Even though no one need agree on the patterns, their emergence will affect coordination between people. In the way words and ideas inevitably mix, agreed upon rules and behavioral norms both become “rules.” Norms come to be regarded as behavioral “rules.” If the study of institutions is the study of how people coordinate through the rules of the game, then the study of institutions becomes the study of the rules of the game that include both agreed-upon-rules and not-agreed-upon-norms.

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<sup>1</sup>Coordination can also be facilitated by relative prices and markets. Institutions do not have a monopoly on facilitating coordination.

The way we have come to think about institutions over the last century or so has taken this particular view of what institutions are and how they work. The opening sentence of Douglass North's *Institutional Change, and Economic Performance* reads: "Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction." He then went on to say that constraints could be formal or informal, they could be rules that people deliberately devised, or they could be norms of behavior that arose because of the tendency for people to follow patterns. The institutional literatures have assumed that rules and norms affect social behavior in essentially the same way, because rules and norms can both be considered "constraints" in the context of individual choice. North's way of formulating institutions as both rules and norms, however, involves a basic paradox. *Rules are devised*: they are agreed to through some deliberate collective process. Agreement does not imply consent. I am subject to many rules that I did not agree to, but the rules were created through an understood process of collective agreement. *Norms are not devised*: they do not result from conscious agreement but through the reinforcing effect of patterns of human behavior on individual choices.

North's basic insight is widely shared among those who study and write about institutions in economics, political science, sociology, anthropology, law, and philosophy (the institutional literatures), including me. Institutions play a crucial role in human societies because coordination between people is facilitated when people's behavior is predictable. I can better coordinate my actions with yours if I know how you will behave in given situations and you know how I will behave. Institutions-as-rules enhance coordination because if we believe other people will follow the rules, then we can better predict how they will behave. Coordination

and, potentially, cooperation between people is made easier in the presence of shared and accepted rules.

There is no doubt about the basic truth of this insight, but one has to question whether the insight justifies the assumption that the primary purpose of rules is to engender predictable behavior through rule *following*. One of the widely accepted facts and puzzles of organizational sociology is that organizations spend time and resources creating rules that no one follows. Why? Why, in the environment of all the rules in a society, rules created by governments, business, schools, families, and organizations of all types, are there so many of the rules in the rule environment not followed? Does that mean that those rules are not enforced? Does that mean that these not followed rules don't matter? If we define institutions as rules then these questions are fundamental to our understanding of institutions, but they are questions that we have not yet asked, much less answered.

Norms of behavior only exist if some group of people behave in a particular manner. Norms *cannot not be followed, because they only exist if* enough people's behavior conforms to the pattern to create the expectation that they will behave that way in the future. In contrast, many agreed upon rules are often not followed in practice, even though they may be enforced in specific circumstances. Norms of behavior and agreed upon rules emerge in societies out of very different social process. Any theory of institutions and institutional change has to account for how institutions are formed. It is impossible, however, to have a common theory that explains how agreed upon rules are formed through a deliberate collective choice process and how behavioral norms are formed through an unintended emergence of patterns of behavior. North explicitly attempts to develop a theory of institutions and institutional change in his book.

North stands out in the institutional literatures for his attempt to systematically think about institutions and economic development, but he is not unique in thinking about rules and norms as basically the same social phenomena.

Categorically stated: if institutions are defined as both agreed-rules-and behavioral norms, then no unified theory of “institutional change” is possible; there must be two theories of institutional change, one for agreed upon rules and the other for norms of behavior. That is the fundamental crippling paradox at the heart of the institutional literatures as they are presently composed. This is as true in philosophy and law as it is of economics and political science (I will give examples later).

How can a rule that is agreed to but not followed produce a pattern of social behavior that influences individual choice? If a rule produces no observable patterned social outcome for people to react to and build expectation on? The first part of the book shows that rules that are agreed to but not followed can have significant and important affects on individual behavior. But these rules cannot affect individual behavior and social outcomes in the same way that norms affect individual behavior and social outcomes, because people can not respond to rules that are not followed by expecting a pattern of behavior to exist. In human societies, lots of agreed upon rules are formed within organizations to coordinate their members, those rules are often not followed, but those rules not only persist over time, organizations continue to devote real resources to forming new rules that nobody follows. These agreed upon rules are not, and cannot be, norms of behavior. But if our theories of institutions only recognize rules that are followed as institutions, then our theory will be seriously deficient, for too many actual agreed upon rules that matter will be ignored by the theory.

The institutional literatures have all ignored agreed upon rules that are not followed. This does not mean that the existing theories need to be scrapped, but that the existing theories are incomplete. It also means the fundamental premises that institutions coordinate human behavior by creating expectations about homogenous predictable rule following behavior needs to be seriously examined and rethought. This book investigates what happens if we actively think about agreed upon rules that are not followed, and how those types of rules affect the organization of societies. The approach to institutions-as-agreed-upon-rules taken here largely ignores norms, and focuses solely on rules formed through a deliberate collective choice process within organizations. This is not to say that norms are not important determinates of individual and social behavior, simply to say that we have ignored important aspects of how rules work.

North explicitly says rules can be informal or formal: institutions can be norms of behavior or collectively agreed upon rules. Since I am saying that rules and norms are not commensurate as social process and cannot (should not) be forced into the same conceptual framework, what follows is not Douglass North's theory of institutions (1981, 1990, 2009). It is not John Searle's theory (1995, 2010), Avner Greif's theory (2006), Daron Acemoglu and James Robinson's theory (2006, 2012, 2019), Acemoglu, Johnson, and Robinson's theory (2001, 2002, 2005), Joe Henrich's theory (2016, 2020), Robert Boyd and Peter Richerson's theory (2004, 2005), Adam Ferguson's theory (1767), James March's theory (1989), Richard Scott's theory/theories, H.L.A. Hart's theory (1961/1994/2012), or Lon Fuller's theory (1964), to reference some leading institutional theorists across the literatures. The theory of institutions that focuses exclusively on collectively agreed-upon-rules as a source of social coordination looks and feels different from any of those theoretical approaches, because it focuses on how the

complete range of agreed upon rules that actually work to enhance coordination in human relationships. Not just the subset of “good” rules that are followed.

Because those missing pieces are not well understood, I have to ask your patience as the argument develops. If you know the existing institutional literature, some of what I say won't sound right initially. But ultimately it all hangs together. It requires us to think differently about institutions as agreed-upon-rules and not to think of them as norms. In order to give you an overview of the argument and put some the pieces in play, this chapter briefly lays out the ligaments of the conceptual framework, the history, and the empirics developed in the book. More emphasis is given to concepts in this overview than the history or the empirical evidence. In the book, Part One develops the ideas. Part Two applies the ideas to the emergence of modern democratic capitalisms in the late 19<sup>th</sup> and early 20<sup>th</sup> century western world. Part Three highlights some empirical regularities connected with modern development consistent with the explanatory story,

Modern economic and political development was occurring in roughly 12 countries by 1920 and 20 countries by 1970. It occurred because those countries were better organized and better coordinated. The key institutional transformation was the ability to create and enforce impersonal agreed upon rules: rules that applied more or less equally to all citizens of a particular society. Those changes in the institutional agreed upon rules liberated the economy and both limited and reorganized the polity in specific ways. The key organizational transformation on the political side was the emergence of consolidated durable political parties. A satisfactory explanation of how changes in the agreed upon rules brought about modern development needs to explain three things: how the rules work to transform the economy, why

some societies began to adopt impersonal rules in the beginning of the 19<sup>th</sup> century, and, critically, how the political systems in the developed societies came to credibly support and sustain impersonal rules once they were first adopted, given that no societies were capable of supporting a wide range of impersonal rules before 1800. It requires both an economic story – how the rule changes promoted economic growth and development – and a political story – how democratic capitalism capable of sustaining impersonal rules emerged. In the end, the framework will do all of that, but getting started on the arguments require some basic ideas. The theory of institutions as agreed-upon-rules rests on a definition and two assumptions.

## *2.2: Rules, Organizations, and the Fundamental Tension*

*The definition:* organizations are groups of people who adopt rules to govern relationships between their members.

*The first assumption:* rules are adopted to increase the value of relationships between the members of the organization.

Organizations encompass the gamut from families, to firms, to universities, to businesses, to states and nations. They are all forms of interactions between people in which rules play a role. The assumption is that rules enhance, rather than “maximize,” the value of relationships, because there can be many people in an organization and how we should weight their different values is too difficult a problem to solve. Rules increase the value of relationships between people by enhancing their ability to coordinate. In this book all “rules” are agreed-upon-rules.

*The second assumption:* any individual who is not better off from belonging to an organizations, i.e. gets a rent from belonging, will leave the organization. The second



assumption is the *participation* constraint. This assumption amounts to assuming people are rational, but it is better to be explicit about the constraint because it plays a central role in the theory.

Taken together the definition and first assumption imply that rules are subordinate to relationships in a way that produces a *fundamental tension*. Rules are adopted to address coordination problems that arise in specific circumstances. There will, inevitably, be circumstances in which following the rule will reduce rather than enhance the value of relationships. In those instances the organization will ignore, amend, or repeal, or change the rule. This is a logical implication of the first assumption. It has nothing to do with cheating, strategic behavior, or corruption. It is a simple result of the fact that we cannot solve all the coordination problems that arise in an organization by the adoption of specific rules.

Rules, however, are better at coordinating relationships if the rules are known and predictable. The fundamental tension results from the fact that rules are always subordinate to relationships. Looking forward in time, since no rule will rationally be applied in all circumstances, therefore no rule's following or enforcement is completely predictable. There is always a tension between relationships and rules, since potential relationships always make rules a bit less predictable, and to the extent that a rule might not be followed or enforced, a rule that is less predictable is less effective at enhancing coordination. Some rules will not be adopted because of expectations that they will not be followed. And many rules will be adopted despite the probability that circumstances will arise in which the organization will not want to enforce the rule. But if the organization can not enforce the rule, its ability use the rule to coordinate relationships "erodes."

By rule following we mean that people's behavior conforms to the form of the rule, e.g. if the speed limit is 60 mph then people don't drive faster than 60 mph. By rule enforcement we mean that resources are devoted to insuring that people follow the rule, usually by specifying a process for arbitrating rule violations and imposing penalties for not following the rule. Rule following and rule enforcement are, therefore, related but conceptually distinct from one another.

This definition of organizations may or may not be controversial, but it is not innocuous. Most explanations of institutions start with individuals. For example, many, indeed most, discussion of legal theory which are all about rules, do not start with organizations but with undifferentiated individuals in a society. The individuals interact with one another, they form patterns of behavior (norms), and social pressures develop within the group to insure that the norms are followed.<sup>2</sup> In these kinds of legal theory, rules emerge out of the pressure of social interaction of their own accord as it were. Laws are articulated norms.<sup>3</sup>

Defining organizations as groups that use rules to order their relationship implies a very different story about the origin of rules. Rules only exist within the context of deliberate choices about rules by groups of people who form organizations. In Hart's framework, a *legal system* appears when *secondary* rules emerge to recognize what the *primary* rules are. Primary rules govern the relationships between people, or between organizations. Secondary rules are rules about forming and changing the existing rules. All organizations have secondary rules, because

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<sup>2</sup>For examples see Hart, 1961/1994/2012, *The Concept of Law*, chapter V, "The law as the Union of Primary And Secondary Rules," pp. 79-100, and the use of Hart by Pettit, 2023, *The State*, pp. 45-60.

<sup>3</sup>Whether this is the right "origins" story for the origin of rules and emergence of laws and legal systems will be taken up in the book.

to be an organization requires agreements about what the rules are, however those agreements are reached. How organizations shape their secondary rules affects the primary rules an organization can form. Secondary rules place rules and organization in a definite relationship. In effect, you cannot have rules without organizations and cannot have organizations without rules. That, however, is not necessary for Hart, or many legal theorists, because primary rules can be norms.

Hart developed the concept of primary and secondary rules to help answer the question “what is law?” His ideas are fundamental. In Hart’s argument, rules appear as social norms. They are “primary rules of obligation,” meaning rules that obligate individuals to do or refrain from doing, specific things. A legal system appears when a group in a society agrees upon secondary rules for making and changing existing primary rules. Secondary rules are rules about making rules. A legal system can only exist if the people in the system who administer the rules know what the rule are, if they recognize what the rules are. In Hart’s terms, secondary rules are rules of recognition, rules of change, and rules of adjudication. These details are important and explored later, but not at this point.

My position is different than Hart’s. My concern is about the use of rules in organizations and societies in general, not just about the rules in a formal legal system. If organizations are groups of people that adopt rules to govern their relationships, then every organizations must have some form of secondary rules that enable them to determine what rules they adopt in the first place. The appearance of rules in human societies was contemporaneous with the appearance of organizations. Rules existed long before formal legal systems. Rules exist in simple foraging bands, as anthropologists amply acknowledge and study.

All organizations have both primary and secondary rules. Even organizations as simple as families have both types of rules, as do organizations as complex as nation states. This is the background for the fundamental tension. All “rules” in this book are agreed upon rules. In the process of deliberations about rules, even if the secondary rule is as simple as what the father says is the rule is the rule, the fundamental tension is always present. The coordinating value of any rule depends on the likelihood that the rule will actually be followed and/or enforced. Some rules are simply “incredible:” it is not to be believed that they will be followed under normal circumstances. Most rules are credible in some circumstances and not in others. Note that this is not about enforcement *per se*. It is the fact that people know that rules will not be followed, or enforced, if in specific circumstances because the value of relationships will be reduced if the rule is followed. So no rule can be completely predictable, since circumstances always change. That is the fundamental tension between relationships and rules.

The fundamental tension is present in all organizations. The organizational literatures are much better describing the tension than explaining it. If it is present in all organizations, then we should expect that the literature on organizations and rules should be aware of the tension, and in a later chapter I will provide examples from sociology, economics, and the institutional literatures that it is well recognized. Unfortunately, tension between relationships and rules is often characterized as a conflict within an organization over rational and irrational modes of decision making, or between logical and emotional modes of decision making, or between predictable and unpredictable outcomes of collective decisions.<sup>4</sup>

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<sup>4</sup>I will not take space here, but both the description and analysis of the fundamental tension tends to revolve around whether or not people are rational, or at least, whether people are

The way we usually think about organizations, however, understandably takes a single organization as the basic unit of analysis. But if we focus only on a single organization, we cannot see how societies mitigate the fundamental tension. In real life the fundamental tension is often mitigated by tying multiple organizations together using rules that can be used across organizations. In the simplest terms, if organization A enforces a rule for organization B, and organization A is insulated from the relationships that make it difficult for organization B to follow the rule, then the fundamental tension can be eased. Very often, organization A and B may form a new third organization, C, to create and enforce rules for A and B. When a new third organization is formed, a fourth organization also appears. It is an *organization of organizations*, whose members are organization A, organization B, and organization C. If organization C is sufficiently insulated from relationships in organizations A and B, then it can mitigate the fundamental tension in those organizations. Organization C is a “coordinating organization.” In any large societies there are many coordinating organizations.

Governments, of course, are the iconic coordinating organizations. Governments specialize in creating and enforcing agreed upon rules that other organizations and individuals can use to better order and coordinate their relationships. A simple way to think about the role of rules in a society is to assume, as Hobbes does, that there is just one coordinating organization that creates and enforces all the rules. Such an assumption is convenient, but problematic, as there are always many coordinating organizations in any society large than a few hundred people, and how the rules interact across all the organizations, not just the government

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usually rational. Which takes off on a side track.

organizations, are central to understanding the institutional structure as well as how particular rules work. Having grasped the concept of primary and secondary rules, the next step is to understand the difference between internal and external rules.

### *2.3 Mitigating the fundamental tension: Internal and External Rules*

As we said, the fundamental tension between relationships and rules always exists within organizations. It is inevitable that relationships will occasionally erode the effectiveness of rules. When I was young, I worked construction and belonged to the Laborers and Hod Carriers Union, which was the lowest rung of the construction trades. I often worked as a carpenter's helper. The union rules, for both carpenters and laborers, clearly stated that carpenters could drive nails, laborers could not. The relationship between carpenters and laborers was an important determinant of the productivity of the construction firms I worked for, but every carpenter was different, and every laborer/carpenter pair needed to be different in order to unlock the potential productivity of each pair. Pairs were heterogeneous, not homogeneous, and rules that enable the heterogeneity to be accommodated were more effective and, for the construction firm, more productive. The last thing the firm wanted to do was mediate disputes between carpenters and laborers over who drives nails, but any rule the firm could adopt would run up against the heterogeneity of the pairs: the same rule would not fit all the pairs. If the firm adopted the nail rule internally, the firm would not always be able to enforce it. Moreover, it would not always want to enforce it. This is the sense in which relationships erode rules. The varied relationships between the carpenters and laborers would undercut the coordinating power

of any fixed nail rule adopted within the firm. Any firm that enforced a fixed rule about driving nails would be leaving money on the table.

But if the union, an external organization, is available to enforce the nail rule, and the union always rules in favor of the carpenter, then each laborer/carpenter pair could adopt their own arrangement (their own agreed upon internal rule), knowing that if there was a dispute that rose to the level of the union, it would be decided in favor of the carpenter. The nail rule would only be enforced if a complaint or case was brought to the union.

The union nail rule is an *external* rule to the construction firm and the laborer/carpenter pairs. If the unions are insulated from the relationships within the firms, the union can ease the fundamental tension within the firms. It is a rule the firms or laborer/carpenter pairs can *access* if there is a dispute between a laborer and a carpenter over who drives nails. The union nail rule provides an *outside option*, and its presence enables the laborer/carpenter pairs to more easily reach agreements about their relationship because they know how the rule will apply if they do not agree, and that in turn makes it easier for the construction firm to organize laborers and carpenters. If the union always rules in favor of the carpenter disputes will rarely arise, because everyone can anticipate the way the rule will be applied: it is impersonal. Relationships between laborer/carpenter pairs do not erode the effectiveness of the union nail rule as long as the union is not affected by the relationships (more on that in a later section).

An extremely common way for organizations to mitigate the effects of the fundamental tension is to form relationships between organizations where they adopt and enforce rules for each other. In the case of the union nail rule the unions, the construction firms, and employees reach an agreement in which the unions enforce the nail rule, mitigating the fundamental tension

for the construction firms and the laborer/carpenter pairs. The firms and laborer/carpenter pairs can be flexible about how nails are driven, but if an disagreement arises and it taken to the union, the union will say “carpenters drive nails laborers don’t.” The nail rule is a *default rule*, it is rule that exists and will be enforced under specific conditions, but it is not a rule that is followed in day to day practice. A default rule is a rule that can be enforced, but is not followed.

Remember, organizations are groups of people who adopt rules to enhance the value of their relationships. Even though the firms and the union may be distinct formal legal organizations, they and the employees in laborer/carpenter pairs (which are also organizations with agreed upon internal rules) are all three in a relationship that uses rules to enhance the value of relationships. The unions, the firms, and the laborer/carpenter pairs are, collectively, an organization. They are an “organization of organizations,” and the logic of organizations of organizations rests on precisely the same definition and assumptions about rules and organizations already posited.<sup>5</sup>

Is this assertion that the fundamental tension can be eased by external rules a reasonable one? Are external rules ubiquitous? Within a single organization the fundamental tension is inevitable. Anyone who studies and thinks about organizations for any length of time realizes that rules are often unenforceable for lots of reasons, but it can be easier to think about rules and organizations if we can assume that rules will be followed. In the economics of contract theory, for example, “The benchmark contracting situation that we shall consider in this book is one

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<sup>5</sup>These kind of relationships are not conceptualized by theories like Hobbes or North, or North, Wallis, and Weingast for that matter, that begin with the assumption that all organizations exist within the same rule environment that is created and enforced by the state. That is true whether the state itself is a single individual or a single organization.



between two parties who operate in a market economy with a well-functioning legal system. Under such a system, any contract the parties decide to write will be enforced perfectly by a court, provided, of course, that it does not contravene any existing laws.”<sup>1</sup>

In real life, the way in which organizations often deal with the fundamental tension is by tying multiple organizations together through rules that can be used across organizations. A rule used by one organization is enforced by another organization more insulated from the relationships that create the fundamental tension. That contract theory assumes that external rules enforced by a third party will always be available is strong evidence of the ubiquity of external rules in human societies. Contract theory assumes that external rules always exist to enforce whatever internal agreements contracting parties reach, that the internal rules of a contract are made viable by the presence of external rules enforced by third parties. The question is where do those third parties come from? We need a bit more background before we can understand how that works.

#### *2.4 Mitigating the fundamental tension: Default and prescriptive rules*

We can draw a representation of external rules, like the union nail rule, as in Figure 1. In the Figure there are four member organizations, like the construction firms, that agree to form a fifth organization, like the union, to create and enforce a common rule, like the nail rule. The ellipses are the member firms (organizations) and the central circle is the “coordinating organization” created by the member organizations. The dashed line indicates that all five

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<sup>1</sup> Bolton and Dewatripont, 2005, p. 3.

organizations are part of the same organization of organizations. I will call this form of an organization of organizations a *rosette*, and discuss rosettes in more detail shortly.

One of the important features of the union nail rule is that the unions only enforced the rule if a firm or a laborer/carpenter pair came to the unions and asked them to enforce the rule. In fact, union representatives were often on job sites, saw laborers driving nails, and did nothing about it. The union nail rule was a default rule: a rule that could be enforced but was not necessarily followed. The opposite of a default rule in this dimension would be a *prescriptive* rule: a rule that is meant to be followed and resources were devoted to enforcing the rule. The form of a prescriptive rule includes the penalties for not following the rule, and perhaps how and by whom it will be enforced.

The unions will enforce the nail rule, but only if a firm or laborer/carpenter pair asks them to render a decision. This is essential to how the external rule addresses the fundamental tension. Suppose the firm adopts an internal nail rule. There will be times when the rule is inappropriate and the firm would prefer not to enforce it. The firm, however, cannot ignore an internal rule without weakening the coordinating power of the rule. The firm, however, can ignore the external union rule when it wants and, at the same time, access the union rule when circumstances require it. The firm will be better off if the union enforces a default rule than if it enforces a prescriptive rule. All four firms in Figure 1 can use the nail rule to coordinate, but all of them can use the rule in the way that suits them best.

Just as with the laborer/carpenter pairs, if the union enforces the nail rule as a default rule, it enables heterogeneity between the firms. Each firm is free to use the rule in the way that suits them best. The coordinating power of the nail rule is greater if it is a default than a

prescriptive rule. The provision of the union nail rules as a default rule produces benefits for the member organization and society in two distinct ways. First, it enables the firms and laborer/carpenter pairs to mitigate the fundamental tension and achieve greater coordination. Second, both within an individual construction firm as well as across all the construction firms in society, it enables a greater degree of heterogeneity within a coordinating field of agreed upon rules. Heterogeneity in that sense is a first order source of greater economic productivity and growth, ala Adam Smith and the logic of specialization and division of labor. Of course, default rules are only better at enhancing coordination in certain circumstances, in other circumstances prescriptive rules may be better coordinators.

### *2.5 Mitigating the fundamental tension: Impersonal and identity rules*

We have assumed, until now, that the unions always enforces the rule impersonally. That is, no matter who the carpenter and laborer are as individuals with different personal identities, the unions always rule that the carpenter drives nails. But what if they didn't? Unions notoriously value seniority. What if when a laborer/carpenter pair comes before the unions, the unions sometimes rule in favor of the more senior union member, sometimes a carpenter and sometimes a laborer. Some of the benefits of the external rule will be retained, but many will be lost. Internally, the firm now needs to be careful and aware of which laborers it puts with which carpenters. The laborer/carpenter pairs will have more complicated negotiations among themselves over driving nails. The opportunity for deception and strategic behavior will further complicate negotiations, for example, how senior are you?

Default rules work better at enabling coordination if they are impersonal: if the rules apply in the same way to everyone.

On this dimension of rules the opposite of impersonal rules are *identity* rules: rules whose form or enforcement, or both, depend on the personal (social) identity of the people involved in using the rule. Identity rules apply differently to different individuals and to different organizations. Although it seems odd today, when all the government rules (laws) in the United States are formally impersonal, to think that rules might apply differently to different people. But in the early 19<sup>th</sup> century, fully three quarters of all the legislation passed by states named specific individuals, organizations, or localities in the legislation itself (see Lamoreaux and Wallis, 2021). In Britain, again, three quarters of all legislation applied to specific individuals or organizations between 1660 and 1830 (Hoppit, 2017). These were all identity rules/laws.

The distinction between impersonal and identity rules is clear conceptually, but it is not a categorical black and white division, and in practice the difference can be more subtle. The union nail rule distinguishes the identity of carpenters from the identity of laborers, but the rule is an impersonal rule only if the personal identity of neither the carpenter nor laborer affects how the rule is applied. Impersonal rules apply to categories of individuals without discriminating by personal identity. It is possible to turn what appears to be an impersonal rule into an identity rule by manipulating the categories. For example, Missouri's constitution required the state to treat all cities the same, but allowed the state to categorize cities by population. St. Louis was the largest city, and the only city in its population category, allowing identity rules for St. Louis even if the form of the rule appeared to be impersonal. The transition from societies that depend

largely on identity rules to ones that depend largely on impersonal rules is an integral part of the emergence of modern societies.

Institutional rules that apply equally to everyone are often thought to be good rules for moral or ethical reasons, they are more “just.” But their importance here is that external rules in general, and external default rules specifically, are better at coordinating individuals within and across organizations if they are impersonal. If both the parties who use the rule do not have to know the social identity of their counter-party to know how the rule will apply to them, the greater the number and variety of relationships that can be sustained and coordination, in general, is enhanced both within and across organizations.

### *3.6 The characteristic dimensions of rules*

Within any society like the very simple society depicted in Figure 1, there is a *rule environment* that includes all the agreed upon rules in all the organizations, and an *organizational ecology* that includes all the organizations. Within the rule environment there are four paired characteristics dimensions of rules:

1. Primary and Secondary Rules
2. Internal and External Rules
3. Prescriptive and Default Rules
4. Identity and Impersonal Rules

These are dimensions rather than categories, the rules exist on continuums of these characteristics. Many rules lie along more than one of dimensions as well. Critically, neither norms, nor beliefs, values, or culture, have these characteristic dimensions. Norms are not

agreed upon rules! If our institutional theories as the rules of the game as both agreed upon rules and norms of behavior, the four characteristic dimensions of rules tend to get lost. That is the crippling paradox of current institutional thinking. The institutional literatures all start from the basic assumption that good rules are prescriptive rules that coordinate better if they are enforced and followed. They all ignore these other types of rules and typically make no distinction between them in the institutional literatures (Hart obviously distinguishes primary from secondary rules). But if we want to construct an institutional theory of societies based around rules, we cannot fail to take all four dimensions into account.

Figure 1 represents the geography of an organizational ecology, rather than specific aspects of the rule environment. It enables us to visualize the ecology of organizations within which agreed upon rules operate. The figure depicts the organizations in the ecology, but only some of the rules in the rule environment. The figure maps the organizations connected to one another by external rules, but the figure tells us nothing about the characteristic dimensions of the rules: are they prescriptive or default rules, are they identity or impersonal rules? In the sociology of organizations Figure 1 would be called an “organizational field,” a term I will use flexibly as the argument develops. The concept of an organizational field is richer than Figure 1, however, since the figure only includes rules and organizations. In sociology, a field includes rules, organizations, norms, beliefs, customs, and myths.<sup>2</sup>

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<sup>2</sup>The sub-discipline of organizational sociology is, of course, an institutional literature. For a clear overview, see Richard Scott, *Institutions and Organizations*, 3rd edition. For an overview of the theory of fields see Neil Fligstein and Doug McAdam, 2012. *A Theory of Fields*. New York: Oxford University Press. For original ideas about fields see DiMaggio and Powell, 1983 and Meyer and Rowan, 1977.

For ease of exposition I call Figure 1 a *rosette*, as the ellipses of the member organizations and the circle of the coordinating organization form a rosette. I will also refer to these as rule and organization *fields* and sometimes an organizations of organizations depending on which aspects of the rosette is being emphasized. All large societies are made up of many organizations or organizations. Together the rules and organizations make up the structure on which social relations are constructed. If Figure 1 were to refer to a whole society, *a rosette world*, rather than a part of society, then the member ellipses would themselves be fields of organizations rather than individual organizations, indeed they could be fields of fields, or alternatively rosettes of rosettes. The fundamental tension infuses the interaction of relationship at every level of the rosette society. All societies bigger than 100 people or so are rosette worlds: *all societies*.

The central insight here is not that all societies are rosette worlds. It is that the component elements of all societies are not just undifferentiated individuals, but rosettes of organizations that are more than individual organizations. They are organizations whose internal institutional structures, their internal rules, depend on the existence of external institutional structures, the external rules created and enforced by the organization collectively in the rosette. What differs between societies is not that they are rosette worlds that use external rules to connect organizations and ease the fundamental tension. All societies are rosette worlds. What differs between societies is characteristic dimensions of the rules they agree to and the organizations that result from those rules. If we do not understand that there are four characteristic dimensions our insight will be handicapped. It will be best to start with how

violence can be organized in a rosette world, since violence and coercion play such a large role in the story we will tell.

### *3: Identity rules and social order*

Addressing the fundamental tension leads organizations in every society to use each other to create and enforce rules. This is not surprising. Governments are organizations that specialize in creating and enforcing rules that other organizations and individuals use, a central feature of almost any theory of the state and any theory of law, from Aristotle to the present. The important insights are that all organizations create rules, almost all organizations rely on some external rules, that fields of organizations connected by external rules and incorporating coordinating organizations are part of every large human society, and that governments are ubiquitous, but not unique organizations. By that I mean that most societies have many coordinating organizations, including many governments; and that governments are just one type of organization that creates and enforces rules. The productivity of the economy, GDP or GDP per capita if you will, is the aggregation of the outputs of all the organizations that make up the economy. The political system of a society is made up of the interacting organizations that make up the economy and society as well as the public and private coordinating organizations that create and enforce the external rules that directly affect the working of the internal rules of other organizations. Institutions are agreed upon rules, and the institutional structure of a society, its combined rule and organizational fields, is a primary determinate of every society's economic and political performance.



Figure 1 is also a very simple representation of power. Secondary rules and the configuration of the organizational ecology is very much the stuff of power in any society. Who gets to make what decisions about what resources is, ultimately, the real source of power in a society. The extent to which those configurations are influenced by the coercive power of organizations, where coercion is the threat of physical violence and thus coercive power is based on the ability of organizations to wield violence, is important and an issue to which we now turn. But it is important to remember as we do that, that power is not the potential for violence, it is the ability to affect the rules under which coordination takes place and to hold positions in the rule environment in which the power to make decisions is located.

The logic of rule and organizational rosettes is represented in Figure 1. The figure depicts an organization of organizations in which four organizations are connected by external rules to a coordinating organization that creates and enforces rules that the other organizations use. Within this organization of organizations the purpose of the rules is to enhance the value of relationships (in this case between organizations as well as between individuals) and the participation constraint still holds: all organizations must be better off from belonging to the organization of organizations. From our point of view, Figure 1 should be viewed simultaneously as a single organization and as five organizations. There is nothing inconsistent in the two views, they are simply two different ways of viewing the same social arrangements.

Later chapters (sections of this paper) will go further into the logic of how such an organization could be structured. For now the first two key issues to address are why are most rules in most societies identity rules and how is violence organized?

## 2.1 A simple model

If organizations are better able to coordinate if external rules are impersonal default rules, then why for most of human history are most rules identity rules? The answer has to do with the fundamental tension, but in a specific setting: the organization and coordination of violence. Many definitions of the state, like Weber's famous one that the state is the organization with the monopoly on the legitimate use of violence, just assert that the state is an organization that uses coercion: the threat of violence. In *Leviathan*, Thomas Hobbes developed a theory that explained how the Leviathan organized violence. Hobbes stands head and shoulders above most political theorists who assume that a state must have coercive power to enforce the rules that ensure greater coordination and security within the society, but they don't explain how violence/coercion is organized. Hobbes actually explains how the state organizes violence (he has a theoretical explanation). How the state organizes violence must affect how the state behaves and what it can accomplish.<sup>3</sup> Any complete theory of states and societies based on the idea that state possess coercive power must, therefore, explain how the state organizes the violence it wields.

Limiting violence is a first order problem for any society. A book I wrote with Douglass North and Barry Weingast, *Violence and Social Order*, lays out a theoretical framework for

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<sup>3</sup>Note that in Hobbes the fundamental tension is not between rules and relationships, it is between the ability of the Leviathan to provide PEACE and the willingness of his subject to obey him and put their capacity for violence at his command. That tension is the methodologically individual innovation in Hobbes's conceptual framework. Each individual desires PEACE in order to escape the state of nature, and are willing to sacrifice liberties and freedoms to do so as long as their fellow subjects are willing to do so. The social contract to obey Leviathan is not a contract between Leviathan and his subjects, but between the subjects.

understanding how violence was limited in most societies and why limiting violence rested on identity rules.<sup>4</sup> The basic idea is straightforward. The really dangerous people in any society are the people who lead organizations that are willing to use violence to pursue their ends. How can these “elites” reach agreements not to use violence against each other that they can all believe will be honored? Historically, the answer seems to be that the elites reach agreements that create rules that apply differently to different elites: identity rules. The rules create specific privileges for specific elites. Economists call the privileges “rents.”<sup>5</sup> Because the existence of the rents depends on the intra-elite agreement being honored, the dangerous elites have some incentives to forgo the use of violence: if they violate the agreement they lose their rents. That is the participation constraint for elites. If the participation constraint fails, agreements break down, and potentially violence breaks out. All members of an organization must benefit from belonging or they exit the organization. In the case of powerful elites, exiting elite agreements can be quite disruptive to the society as a whole. Elite agreements in most societies, however, are usually fragile because the value of rents can never be fixed through time, circumstances always change. North, Wallis, and Weingast call these societies “natural states.” The “logic of the natural state” is that social order is maintained by creating economic rents and manipulating the economy to make political agreements credible.<sup>6</sup>

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<sup>4</sup> Although the book did not use the term “identity rules,” it did talk a lot about personal relationships and rules based on social identities. The figures and specific analysis that follow were developed in Wallis (2011) and North, Wallis, Webb, and Weingast (2013).

<sup>5</sup>The concept of an economic rent is more subtle and complicated than simply a privilege, but that will get us on from here for now.

<sup>6</sup>The logic of the natural state reflects the fundamental tension on a larger scale. The fact that elites must reach an agreement that structures the rules governing the relationships in such a way that all the elites get rents is necessary to meet the participation constraint. But the fact that

We can see how the logic works by beginning with two small groups as in Figure 2.

Both groups have war leaders.<sup>7</sup> Organization A's war leader is A and its members are the "a's;" Organization B's war leader is B and its members are the "b's." Initially there is no agreement between the groups and within each group the war leader is only the leader by virtue of the value he creates for the members of the group, otherwise they depose him. Neither A or B can rule their group by coercion, because acting collectively the a's can always overwhelm A, and the same for the b's and B.<sup>8</sup> The vertical ellipses are initially two organizations with no recourse to external rules to help enforce their internal agreements. All the rules in organization A are internal rules, as are all the rules in organization B. How could the leaders of the two groups reach an agreement by which each leader agrees not to fight and to support the other? In order for such an agreement to work both leaders must be made better off by the agreement (the participation constraint). Further, each must believe that the other will abide by the agreement

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those relationships will shift with changing circumstances makes the rules that the elite agreements create less than completely predictable. In most societies, elite agreements break down frequently and societies are worse off when they do.

<sup>7</sup>There is an enormous literature in anthropology about the organization of hunter gatherer societies and the infinite variety of ways in which they ensure a rough equality of outcomes for their members. Christopher Boehm's work (1984, 1999, and 2012) is a good place to start. The opening chapters of Flannery and Marcus (2012) provide a summary and review of the literature.

<sup>8</sup>This is Boehm's logic of aggressively egalitarian societies. See Boehm (2012) *Moral Origins: The Evolution of Virtue, Altruism, and Shame*, who argues that human beings developed a strong sense of egalitarian preferences because that was necessary to keep single individuals and leaders from becoming too powerful. In the *Narrow Corridor*, Acemoglu and Robinson, build this idea into a theory of "Absent Leviathans," societies that deliberately refuse to be governed by a state. That one person can never coerce a group of people is a fundamental assumption of Hobbes's logic as well.

within certain conditions. If A puts down his rock, what is to prevent B from killing A? How can the leaders believe the agreement will be honored, by both sides?

The solution provided by North, Wallis, and Weingast supposes that both leaders agree to recognize and support each other's control over the land, labor, and resources in their respective groups. In effect, the two war leaders create a third, coordinating organization and that organization agrees to establish and enforce property rights for each war leader to the land, labor, and resources in their respective groups. North, Wallis, and Weingast assumed that if the war leaders coordinate with each other, then the war leaders are able to defend themselves by coming to each other's aid: the two war leaders acting together gives them enough coercive power to control the rest of the population. The example is too simple, and this assumption is too simple too, but it works to illustrate the logic. The war leaders form an alliance which organizes their violence through coordination. Neither A nor B puts down their rock, it is essential to the agreement between A and B that they both continue to possess coercive power. Their organized violence enables them to coerce the a's and b's.

The war leaders reach an agreement that binds them into an organization, the horizontal ellipse in Figure 3. A and B cannot appeal to an external third-party to enforce their agreement. By virtue of their agreement the two leaders have a claim on all the output their respective organizations produce. The horizontal ellipse is not a credible organization on its own terms, because the relationship between A and B depends on the existence of the two member organizations. It is the rents that A and B get from their member organizations that make their agreement credible. Figure 3 is a simple rosette world, like Figure 1, with one coordinating

organization and two member organizations. The entire rosette is a simple society, an organization of organizations, an organizational field.

The figure contains three binding participation constraints. All the a's must find it in their interest to belong to organization A, all the b's to belong to organization B, and A and B must both find it in their interest to belong to the horizontal ellipse. The rules that A and B agree to adopt must enable them to meet all three participation constraints. What the coordinating organization can do *is not arbitrary*, the agreement between A and B is quite constrained by all of the participation constraints.

Because land and labor are more productive and valuable in the presence of PEACE, this creates visible and credible incentives for both leaders not to be violent. There is a double advantage here. When the world is peaceful, both organization A and organization B will be more productive. At the same time, the agreement between A and B enables them to provide external rules that the A and B organizations can use to order their internal rules, also making them more productive by enabling internal rules to be used that otherwise would be weakened or rendered "incredible" by the fundamental tension.

War leader A knows that if war leader B defects from their agreement, the resulting violence will lower the rents that war leader B gets from his organization, and vice versa. Each war leader can see that, under the right circumstances, the other war leader has an incentive to honor their agreed upon rule not to use violence against each other. Each can also see that there are circumstances in which the other leader will defect from the agreement and fight. In this simple world, A and B have figured out how to reach an agreement that organizes violence by creating rules that enable them to use rents to make their agreement credible. They have figured

out how to create a third, coordinating organization, that creates and enforces external rules for the member organizations. The a's and the b's are collectively better off in the aggregate if A and B can figure out a way to limit violence. That does not imply that any specific "a" or "b" is better off, however.

This is not Hobbes's logic. In Hobbes, the a's and b's agree among themselves to recognize the authority of A/B only if A/B provides peace. Hobbes does not envision organizations interacting in this way.

The agreement the war leaders reach creates a bundle of rules. A and B are not creating norms, they are creating agreed upon rules. Some of the rules allocate resources between their groups. Some of the rules spell out responsibilities the war leaders have with respect to one another. Other rules concern the organization of the a's and other rules the organization of the b's. Because the agreement depends on the rents accruing to A and B as specific individuals, the rules are typically identity rules. The agreed upon rules create specific privileges for A, for B, and different rules for different people among the a's and b's.

The war leader example is too simple, but its simplicity highlights the logic of how violence could potentially be organized and controlled by the creation of agreed upon rules that create and organize economic privileges. A and B are not able to create rules because they are powerful, they become powerful because they are able create agreed upon rules that enable them to credibly organize themselves. The political agreement reached between the war leaders involves an economic component, each war leader controls the land, labor, and resources in his organization that makes the political agreement credible and sustainable. Economics and politics are directly linked in the logic, because the ability of the war leaders to form a credible

agreement depends upon the economic arrangements they make. Violence can be organized by manipulating economic interests in such a way that the dangerous people have an incentive not to fight each other and, when circumstances call for it, to fight together. In a phrase that will be repeated throughout the book, “political agreements manipulate economic arrangements in order to make political arrangements credible.” Economic interests are created and manipulated through identity rules. Organizing violence typically includes arrangements that also limit the use of violence. Violence cannot be organized by violence, but it can be organized by the manipulation of organized economic interests.

### *3.2 The fundamental tension and the persistence of identity rules*

Suppose we assume that there are four war leaders, as in Figure 4. If we look down on Figure 4 from the top, and flatten out the four ellipses, we get Figure 5, which looks identical to Figure 1. This is not a coincidence. Organizations of organizations are still organizations. As we shall see, however, whether Figure 1 and Figure 5 are actually identical to each other depends on the rule environment. While the figures look identical, the figures do not express the underlying rule environment in complete detail. The concept of a rosette world is quite general, it applies to societies organized purely by coordinating the interests of different organizations through external rules, as in Figure 1. It applies to societies organized by the systematic organization of violence and the use of coercion based on that capacity for violence create and enforce external rules, as in Figure 5. The characteristic rules underlying Figures 1 and 5 may be similar or they may be different. What is missing in both figures is the explicit rule



environment. Understanding the difference between what is missing in Figure 1 and what is missing in Figure 5 is key to the emergence of modern societies.

The fundamental tension between rules and relationships is particularly acute when the relationships at stake are between powerful, and potentially violent, elites who adopt rules to order their relationships for the purpose of limiting violence and sustaining social order. The rules they adopt have to benefit each elite individually in a way that will be adversely affected if violence breaks out. In Figure 5 the coordinating organization is the organization of the four war leaders. The rules the coordinating organization adopts are made credible by the rents the identity rules create in the member organizations. The logic of forming organizations is the same whether the organization uses violence or not, violence is not the essence of either Figure 1 or 5.

However, in societies organized by the logic of the natural state, identity rules prevail. Since impersonal rules do not create rents for individuals – they treat everyone the same – impersonal rules cannot be the kind of rules that make these kind of agreements between elites credible. Every elite must feel that the existing intra-elite arrangements benefit them individually. That is the participation constraint. If an elite organization feels that it loses by the current arrangement, it will exit the agreement. That will raise the potential for violence and civil war. If an elite threatens to defect from the existing agreement, other elites may be willing to change the rules to prevent violence, but if they change the rules to benefit the elites who are about to abandon the agreement, they will utilize identity rules, they will not change the rules to benefit everyone equally. That would not produce rents to bring the elites threatening to abandon the agreement back into the fold.

The intra-elite agreements are organized by identity rules and necessarily include groups with competing, even antagonistic interests. They are not just made up of allies. Maintaining social order depends on inducing the powerful factions that are most likely to fight each other to agree to coordinate. To give an example, former president Mwai Kibaki of Kenya was declared the winner of the 2007 elections despite the claims of his opponent, Raila Odinga, that the election had been manipulated. Violent protests broke out and Kenya seemed on the verge of civil war, but violence was forestalled by an agreement between the Kibaki and Odinga organizations that allowed the former to assume the presidency. Entitled the National Accord and Reconciliation Act of 2008, the agreement rewrote the constitution and created the office of Prime Minister, which was given to Odinga. The Accord was an intra-elite agreement between enemies, not allies, and very consciously used identity rules to quell violence.<sup>9</sup>

How a society, or a state, organizes violence affects how that society or state behaves. If violence is organized by coordinating powerful organizations through the creation of identity rules, then in that society the rules and organizations in the economy will be manipulated for political purposes. These societies will not be capable of creating and enforcing impersonal rules on a broad scale, as doing so would threaten the basis of social order. Identity rules are very persistent over time in these societies.

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<sup>9</sup> See Jeffrey Gettleman, “Disputed Vote Plunges Kenya Into Bloodshed,” *New York Times*, December 31, 2007. See also Nic Cheeseman, “The Kenyan Elections of 2007: An Introduction,” *Journal of Eastern African Studies* 2 (issue 2, 2008): 166-184. The entire issue of the journal was devoted to the Kenyan election.

### 3.3 *The fundamental tension at the level of societies*

If Figures 1 and 5 are reasonable depictions of the relationships between organizations that make up rosettes, and if we think of societies as bundles of rosettes, or of organizational fields, then a full picture of society would still look like the figures, only the ellipses in the larger picture would themselves be rosettes, instead of individual organizations. In fact, the ellipses could be “rosettes of rosettes” as different fields also form relationships with each other.

Two implications follow. First, that within any society there will be many coordinating organizations, some linked to each other through external rules, and many rules in every organization and every level of organizations. It does not make sense to think of the rule environment as the sole product of one coordinating organization: the Leviathan or the state.<sup>10</sup> In any society the government(s) only formulates a small share of the rules that make up the rule environment. In very general terms, the effectiveness of a particular society’s rule environment at sustaining and enhancing coordination will depend upon the extent to which the agreed upon rules lie further along the dimensions towards more external rules, more default rules, and more impersonal rules. That is, more external impersonal default rules.

Second, if we think of a society’s fields as organized in hierarchies, rosettes of rosettes (which is not exactly the right way to think about them, but hold that thought until later) then as we move up the hierarchy of rosettes the fundamental tension between relationships and rules becomes more problematic. This is an implication of North, Wallis, and Weingast’s logic of the

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<sup>10</sup>See, for example, North’s theory of the revenue maximizing monarch (1981), or Mancur Olson’s theory of the roving bandit (1991), or Barzel’s theory of the state (2001), Margaret Levi’s *Of Rule and Revenue* (1988) , or Robert Bates’s model in *When Things Fall Apart* (2008).

natural state that underlies the A/B world and Figure 5. In most societies as we move up the organizational hierarchy, the organizations become more powerful and the danger that violence might break out between them if their agreements breaks down becomes greater. At the highest levels of society *relationships always drive rules*. At the highest levels of society there cannot be an external coordinating organization to shift enforcement to. A and B will always be willing to change the rules (their agreement) if circumstances shift enough that the old agreement is no longer credible. *What is important to A and B is the ongoing value of their relationship, not whether they follow the rules or not, and that is the fundamental tension*. If circumstance shift enough, it may not be possible to keep A and B in agreement and violence will potentially break out. Since circumstances always change and rents can never be fixed, societies with that use identity rules to maintain stable intra-elite relationships are always fragile and unstable in the long run, even if not in the short run. Since long run stability is the result of ongoing short run stability, identity rules are the best these societies can do.

The political system in identity rule societies produces laws that apply differently to different people, particularly people with different social identities. As a result, political competition and political organization in these societies is *factional*. The political systems is made up of many relative small, ephemeral factions with specific political interests that they pursue, in a constantly shifting coalitions of factions. I will return to this later, as one of the main changes that occurs in impersonal rule societies is the character and behavior of political parties, and in most societies political parties are themselves factions made up of factions.<sup>11</sup> On

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<sup>11</sup>For a clear conceptual discussion of factions see Andrew J. Nathan. 1973. "A Factionalism Model for CCP Politics." *The China Quarterly*, Jan. - Mar., 1973, No. 53 (Jan. - Mar., 1973), pp. 34-66

the political side, the emergence of modern developed societies involves the transition of political parties from fragmented factional coalitions into integrated and *consolidated* party organizations. Part Two explicitly address how a modern consolidated democracy with a few durable well organized consolidated political parties comes into being. Before addressing that, we need to think about impersonal rules in greater depth.

#### *4: Impersonal rules and modern societies*

The institutional origins of modern societies are found in societies that adopt impersonal rules on a broad scale. In the context of economic growth and development, we often ask why the governments in a society are unable to create and enforce impersonal rules, why can't they credibly commit to rules that are unbiased and enforced uniformly? Why can't they support the rule of law? The previous sections suggest a different way of asking the question: why can't or don't the coordinating organizations in a society create and enforce impersonal rules? The two ways of asking the question are not identical, but their answers have a common root in the interaction of rules and organizations. The answers are complicated and co-dependent, that is, whether private organizations or fields are able to use impersonal rules, both external and internal, depends in part on whether public government organizations are able to create and enforce impersonal rules. A better understanding of the relationships between coordinating organizations and member organizations is the key, which is why an approach which takes the

government as a single actor interacting with many individuals, the approach used by Hobbes or North, cannot get at these relationships.<sup>12</sup>

What this boils down to is whether we can use the logic of the rosette world, represented in Figures 1 and 5, to explain why the organizations in a rosette world would find it in their interest to come to an agreement in which the coordinating organization(s) is (are) charged by the agreement between the member organizations with creating and enforcing impersonal rules? Explicitly, why would the powerful organizations of government and the organizations that influence governments find it credible for the government to promise to create only impersonal rules that apply equally to all citizens. That is the core question this book tries to ask and answer.

The transition to impersonal rules has direct effects on a society's economy and polity, as well as indirect, endogenous, and dynamic effects. Their effects on the economy are easier to see and understand, even though they have largely been overlooked. Their effects on the polity are more complicated. We begin with the economic effects.

#### *4.1 The economic effects of impersonal rules*

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<sup>12</sup>This is not to say that methodological individualism is irrelevant to answering these questions, but it is clearly not enough. The formation of organizations using rules clearly must be compatible with the interests of the members as individuals, that is the participation constraint. At the same time, how the members decide to organize themselves shapes the choices they face, both because of agreed upon rules and norms of behavior, as well as the beliefs and values that they hold. How individual choices affect aggregate outcomes is mediated by the structure of rules and organizations in the particular society individuals are in, and then how aggregate outcomes affect individuals is likewise mediated by the organizations people belong to. These are deep questions that this book tries to wrestle with.

The societies that first adopted impersonal rules in the 19<sup>th</sup> century were all identity rule societies, but they were also what North, Wallis, and Weingast would call “mature natural states.” Mature natural states on the “doorstep” of a transition to impersonal rules exhibited three characteristics: 1) “rule of law for elites:” credible identity rules governing intra-elite relationships that non-elites had limited or no access to; 2) institutional support for perpetually lived organizations: organizations (often formally corporations) whose identity as an organization was independent of the social identities of the individuals who made up the organization; and 3) political control of the military. I would now add a fourth condition 4) a republican form of government.

This is another way of saying these societies had rich rule and organizational fields, much more complicated versions of Figure 1 and Figure 5, that were capable of creating and enforcing identity rules that varied according the social identity of the individuals to whom the rules applied and a rule environment in which elite organizations could access formal external rules to both form and structure their organizations. Most of the rules in the society were formed by private organizations, but there were many coordinating organizations that straddling the boundary between private and public organizations. The coordinating organizations included many governments and quasi-governmental organizations (for example, guilds) in these societies. In the abstract, what would happen to the rule and organization matrix (field) if the governments adopted an impersonal rule provision that required all government rules to be impersonal?

One of the central set of rules in any society are the rules for forming and operating organizations. In identity rule regimes the ability form organizations is limited, and equally the

ability to access external rules created by the government to help with the internal relationships of organizations is likewise limited. The most apparent direct effect of moving from an identity to an impersonal rule regime is an increase in the number of organizations. In Britain and France in the 19<sup>th</sup> century this transition produced an increase in corporate organizations by an order of magnitude (North, Wallis, and Weingast, 2009, pp. 213-227, and particularly the work of Freedeman, Scott, and Harris). The other direct effect is to give all the organizations access to the external rules for organizations created and enforced by the governments. When the number of organizations increases that, in itself, is a source of economic growth, as the degree of specialization and division of labor increases with the number of organizations.

An example of increasing numbers comes from Sweden, where two laws allowing freedom of association – Handelsordningen ('Trade Regulation') and Fabriks och Handtwerksordning (Factory and Handworks Ordinance) 22 December 1846 -- were followed in 1848 by a Companies Act. The 1846 acts concerned labor relations and the ability of workers to organize and engage in businesses. Changes in the old labor rules that often bound employees to employers (guild regulations for example), were implemented. “From the beginning of the Nineteenth Century, tendencies to liberalise labour conditions grew. Due to the upcoming liberal ideas, old restrictions on the right to exercise a trade were abolished one by one. Everybody was entitled to carry on any business (such as commerce, manufacture or handicraft) he liked (basic legislation on this was issued in Norway 1839, Denmark 1862, Sweden 1864 and Finland 1868).” (Ole Hasselbalch, “The Roots – the History of Nordic Labor Law.” *Scandinavian Studies in Law*, vol. 42, pp. 11-35, 2002.) Before these laws most individuals and groups did not



have the right to form a business outside of the recognized guild organizations. The number of organizations increased.

So too did the ability of organizations to access external rules open more widely and impersonally. “The Danish Supreme Court ruled in 1827 that private associations could be recognized as separate legal entities without government approval (Danish Committee on Comparative Law, 1963). By 1824, Danish authorities (*Kancelliet*) had also published a statement that made precise that only privileges of “monopolistic and extraordinary” character required government concession (Dübeck, 1991).”<sup>13</sup> This not only meant that the associations were allowed to form, it meant that associations could form at will, and that they could access the external rules the Danish government would enforce for organizations. Here is how Dübeck put it:

In nineteenth-century jurisprudence the interest in "anonymous societies" with a fixed fund was growing. The great jurist A.S. Ørsted (1778-1860) considered that a person entering a contract with a society [a corporation] must take the consequences if he had reason to believe that this legal or moral person was not trustworthy. As early as in 1818 Ørsted deemed that the capital of a society could be responsible for its debt. Against this background it is not surprising that the Danish Supreme Court in 1827 was satisfied with the agreement or memorandum of association as a sufficient basis for authorizing the sole and only responsibility of the fund and not that of the shareholders in person. The concept of a legal person was hereby changed, to become identical with an autonomous legal subject instead of being just another expression for a "responsible society" with

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<sup>13</sup>Charlotte Ostergaard and David C. Smith, “Corporate Governance Before There Was Corporate Law,” Centre for Corporate Government Research, Working Paper, No. 3/2011, April 2011, p. 7. The text has a typo and cites “Lübeck” rather than “Dübeck.” I have obtained a copy of the *Danish and Norwegian Law: A general survey* edited by the Danish Committee on Comparative Law, Copenhagen: C.E.G Gag, 1963, which is in English but have, so far, been unable to find the 1827 citation in that book (I have looked through the text but have not been able to read it carefully). The Dübeck reference in the Ostergaard and Smith working paper, is to Inger Dübeck, 1991, *Aktieselskabernes Retshistorie* (Jurist- og Økonomforbundets Forlag, København), 1st edition, which is in Danish and I am hoping I can obtain a copy and Toke can read it.

joint and several responsibility for each person. (Dübeck, 1993, *Scandinavian Studies in Law*, p. 20)

Adopting impersonal rules for the formation of organizations gave all the organizations access to the existing external rules for structuring and governing that the government would provide and enforce, access was denied to most potential organizations under the existing identity rules. These changes enabled an organization to become a “legal person” if the organization so desired, and as legal persons to access external rules for organizations.

The movement to impersonal rules for organizations produced an increase in the number of organizations, relative to the size of the population, and those organizations gained access to external rules for forming and operating organizations. Three additional indirect economic effects follow from the transformation of the existing identity rules into impersonal rules. They can be grouped under the terms heterogeneity, innovation, and liberty. Of the three heterogeneity is probably the most important direct economic effect. Not only is heterogeneity a first order source of economic growth on its own terms operating through specialization and division of labor, but the effects of both innovation and liberty feed back through heterogeneity as well. A fourth effect, stability, will be discussed in a later section. Increased stability is another important economic effect, but it also operates through and affects the political system and will be taken up in Part Three. The transition from identity external default rules to impersonal external default rules creates benefits from heterogeneity and stability. Because default rules are not part of the traditional rules bestiary in the institutional literatures, these benefits are not recognized or well understood.

In the union nail example the presence of the nail rule as an outside option enables laborer/carpenter pairs to reach agreements about their own relationships at lower cost because of the existence of the external rule. The default rule also enables each laborer/carpenter pairs to reach their own, unique and so heterogeneous arrangements. The construction firm benefits because each laborer/carpenter pairs could be more productive without requiring the active management of the firm. An external prescriptive rule would not allow heterogeneity, and an external identity default rule would significantly raise the costs of negotiation agreement between the laborer/carpenter pairs and within the construction firm.

Similar effects occur throughout the rule and organization fields of a society whose public coordinating organizations, their governments, adopted impersonal rules. All organizations would have access to the same external default rules and every organization could use the rules as outside options to make credible arrangements within the organizations that were unique, and therefore heterogeneous, across organizations. On its own, increased heterogeneity would produce economic growth *and economic development* through its effects on the degree of specialization and division of labor. Economic development refers to the sophistication, complication, and diversity of organized activities within the society, rather than the simple accounting of the aggregate production of goods and services.

Increasing the number and heterogeneity of organizations undertaking specific tasks increases the overall rate of innovation in the techniques available to perform those tasks. More organizations exploring and employing more and different options for solving similar problems and challenges produces an increase in the probability that some innovations would successfully solve the problems. The rate of technological change and the rate of innovation would increase

even if the same number of organizations moved from an external identity rule regime to an external impersonal default rule regime, simply because of the increase in the heterogeneity of solutions to organizational problems that impersonal default rules enable. Over time, increasing rates of innovation feed back into the extent of heterogeneity among organizations in any particular rule and organizational field, and to the larger society as well.

Since the late 18<sup>th</sup> century classical liberal thinking has argued that government rules should apply equally to everyone and that a minimum number of rules should be enacted. There is both a strong liberal, or perhaps neo-liberal, tradition and Austrian tradition (Hayek) that argues for minimal government rules governing the economy because those prescriptive government rules impinge on and reduce the liberties and freedoms of individuals. Hayek, in *Law, Legislation, and Liberty* explicitly argues that good rules emerge out of norms of behavior that a community develops through the process of “spontaneous order.” Rules that the government arbitrarily imposes are as likely to cause harm as good.

While that logic may work for prescriptive rules, it doesn't work for default rules. An impersonal default rule allows individuals to enter into relationships with each other, using the default rule as an outside option, and imposes no restrictions on the form of the relationship other than what the parties can arrange and devise to make their relationship credible. People who live in rule of law, impersonal rule, open access societies do not enjoy more freedoms and liberties because their governments are smaller. Governments in those societies are measurably bigger, both fiscally and in the number of rules and courts they possess. Nor did their citizens enjoy more liberties and freedoms because their governments are more limited, although they are limited on some dimensions. They enjoy the freedom and liberty to interact with people in a

much large space of relationship supported by impersonal default rules that are enforced, but not followed. They can depend on the rules being enforced, but experience neither compunction nor coercion to follow them. Their relationships can take any form not prescribed by the prescriptive rules. The classic liberals deplored these kinds of prescriptive rules, but from the liberal's language took was largely about rights without understanding that the rights they treasured and celebrated were largely protected and sustained by external impersonal default rules that enable societies to enjoy particular rules for many aspects of their lives, without having to follow those rules.

This becomes more true when impersonal rules spread beyond the rules for forming organizations to other areas of government laws. For example, the state of Indiana wrote a new constitution in 1851. The constitution contained a provision that required the legislature to pass "general laws" (the American term for impersonal rules) for 17 specific functions, and general laws whenever possible. These kinds of provision enabled organizations to take advantage of impersonal external rules for many purposes, and many of the rules were explicitly or implicitly default rules.

The effect of moving to impersonal rules is to increase the number of organizations and their access to external rules, both default and prescriptive. The effect of impersonal external default rules is to increase the heterogeneity of the organizational ecology which encourages innovation, which feeds back into heterogeneity. The effect of impersonal external default rules is to increase personal liberty, also in a way that feeds back into heterogeneity. Through its effects on the degree of specialization and division of labor, heterogeneity is a first order source of economic growth and economic development, which produces a virtuous feedback process.

#### *4.2 Impersonal rules and political outcomes: The First Question*

Now to the political side. An impersonal rule regime is not a naturally occurring phenomena. There were no human societies before the mid-19<sup>th</sup> century with governments that typically created rules that applied equally to broad classes of citizens and where the governments deliberately limited their own tendencies to create rules for individuals organizations that enjoyed unique privileges. Even today there are no societies with governments whose rules are universally impersonal. So the degree of impersonality in a legal regime is a matter of degree, even though I will often talk about identity and impersonal regimes as if they were categorical black and white differences. No societies can become impersonal rule regimes unless their governments decide to adopt and enforce impersonal rules and, critically, continue to do so through time. And, unfortunately, despite the importance of impersonal rules to concepts like the rule of law, equal protection before the law, or equality and justice, there are no general histories of how or why the twenty or so societies with impersonal rule regimes today initially adopted them or how the systems are maintained.<sup>14</sup>

Two closely related but distinct questions have to be asked and answered. The first is how do societies come to adopt impersonal rules in the first place, the second is how impersonal rules are sustained as a persistent political outcome over time? The lack of comprehensive general histories of impersonal rule adoption makes the first question problematic, and there is no comfort in the conclusion that different societies first adopted impersonal rules for different

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<sup>14</sup>This is not to say that there are not pieces of such a history of impersonal rules, but that there are no integrated general histories. Naomi Lamoreaux and I have been working on developing such a history for United States and, more generally, for the developed world in the 19<sup>th</sup> and 20<sup>th</sup> century. You can track the development of those ideas and that history in Wallis (2005 and 2006), and Lamoreaux and Wallis (2021, 2022, 2024a, and 2024b).

reasons. While there is a great deal of truth to that conclusion, it does appear that the movement to impersonal rules as a general feature of a government's laws results from forces inside the political process having to do with the internal dynamics of political organizations – parties – in a competitive democratic electoral system. This does not mean that a basic democracy with elections will eventually develop impersonal rules. Roughly two-thirds of that nations in 2024 have elections and only twenty or so have impersonal rule regimes. Something like the three, or four, doorstep conditions need to be in place before a society can begin to transition to impersonal rule. Even then, transition are not inevitable as will be shown in Part Two.

The key point of the insights concerning rules and organizations presented a few pages ago is that when organizations face difficulties with the use of internal rules because of the fundamental tension, they turn to forming relationships with other organizations and, ultimately, the formation of coordinating organizations to create and enforce external rules that can help them mitigate the adverse effects of the fundamental tension on their internal rules. In a democratic system control over at least one of the coordinating organizations is subject to contestation through election, at least partially if not entirely. We call the organizations that compete in that electoral process political parties, even though the nature of political organizations changes dramatically as a society develops. When political organizations find that they are unable to achieve the level of coordination *within their own party* because of the conflict between relationships and rules. Political organizations suffer from the fundamental tension in spades. Their members have agendas of their own, but must coordinate on rules that order the party organization sufficiently to win elections. But relationships between factions within parties are always fragile. If parties are to change the kind of rules that the coordinating

organization can formulate to ease the fundamental tension within parties, all the parties may be willing to support those rules. Here the political factions are the member organizations and the legislature is the coordinating organization that the factions belong to. The participation constraint holds. All the parties who participate in the electoral political process must find it in their interest to do so, and they can collectively shape the rules the coordinating organization creates and enforces. If significant factions find it in their interest to leave the agreement, then social order begins to fall apart.

The basic logic of external rules as a way to mitigate the fundamental tension is at work here as well. All of the political organizations competing for control of the government are part of the rosette dynamics represented in Figures 1 and 5. For most societies, the imperative of maintaining social order requires that the rules adopted through the coordinating organization are identity rules. The polity consists of many factions, small groups with shared, narrow interests in shaping the rules and policies of the government who come together in ephemeral coalitions that are constantly shifting. In a society that uses identity rules to stabilize social order, factions are rooted in the rosettes that contend for influence on and control over the government. All societies are rosette worlds, but in identity rule societies the large integrating rosettes that appear in modern developed societies do not exist, or are extremely weak. The component pieces compete for influence over the government and what they strive for are policies and rules that benefit their faction. Identity rules are the glue that holds those coalitions loosely together internally. The external a faction hopes to access from the government are external rules that address the specific needs of their rosette, that enhance the internal rules of the their rosette and the organizations within the rosette. Factions are not atomistic individuals, they are groups of



people attempting to coordinate to pursue a common end. They are organizations even if they are not well organized.

Identity rules by their very nature are intimately connected to social relationships and are more fragile than impersonal rules with respect to changing social identities, relationships, and circumstances. The hopes that identity rules can secure stability can be realized in the short run, but in the long run will be frustrated by the inability of any political agreement to fix the economic rents that hold the coalition agreement together.

We can start from an identity rule regime, with a republican form of government, that uses elections to select some or all of its leaders, where the characteristic outcome of the legislative process is identity rules, say 75 percent of all legislation. Such a polity will be inherently “factional:” the ellipses that make up the rule and organization field that compose the polity will be numerous, small, and focused on gaining specific benefits from the political process, and the political process will deliver identity rules that benefit specific individuals, organizations, and localities.

There will be sets of secondary rules that govern the selection/election of leaders, determine how laws are made, what the laws can and cannot do, and how policy responsibilities are allocated within the organizations that make up the government. I will call those “constitutional” rules without implying a written constitution or any particular coherence to those rules within a specific society. It matters how, within a legislature, a collective agreement is reached about creating new rules or amending old rules, the secondary rules, but I am not particularly concerned what those secondary rules are as long as they exist in some form.

Leaders in the political process are tied to factional interests. Say the rule for creating legislation is a majority of the legislature. Individual legislators can form into coalitions capable of generating a majority. The benefits an individual legislator receives will be tied to the benefits that her constituents receives, and her faction may or may not share in those benefits. Since we are in an identity rule regime, majorities will commonly form around bundles of identity rules, where each bill affects only one legislator (or a few) and the bundle of such rules commands a majority. We can call this kind of legislation private, special, and local legislation to reflect whether the legislation benefits specific individuals, specific organizations, or specific localities. Each legislator will have interests in passing private, special, and local legislation.<sup>15</sup>

A leader who desires a particular general legislative outcome must assemble a coalition of individual legislators. Coalitions of legislators, legislative parties in Duverger's term, who desire to achieve larger legislative outcomes requiring more resources and time need to build larger more durable coalitions. The identity basis of the legislature, however, will frustrate such a desire, because legislators are beholden as much or more to their specific factions and local interests, than to the larger party. Legislators can perform their representative function by delivering identity rules to their constituencies, independent of party policies, and the party cannot take that away from them under a simple secondary majority rule for passing legislation.

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<sup>15</sup>The terms private, special, and local correspond roughly to the terms American states used to designate the different types of legislation in the early 19<sup>th</sup> century. Every state was a little bit different, however, and in historical situations the terms need to be used carefully. The American terms do not correspond with the British or European terms. In comparing Britain and the American states one has to be very careful about what "private" legislation means. Indicative of the importance of identity rules in the early 19<sup>th</sup> century, both the Parliament in Britain and many American states kept separate records of identity legislation (private, special, or local) and impersonal legislation (general) in their published laws and internal records.

Even if a significant number of individual legislators in a coalition would like to pursue more coordinated outcomes, their efforts will be frustrated by their collective inability to discipline themselves. If that sounds like an exaggeration, it is not, but it is something that can only be seen with a sense of historical development. Legislatures and parties in the early 19<sup>th</sup> century were not the same as legislatures and parties in the late 20<sup>th</sup> century.

Legislatures are organizations that create rules, including rules for governing themselves. There is no technical reason that a group of like minded legislators who want to pursue larger collective goals frustrated by the factional nature of the legislature could not pass a new secondary rule requiring all legislation to be impersonal, for all legislation to apply equally to all citizens (or some large impersonally defined group of citizens). The purpose of the secondary rule requiring legislation to be impersonal rules would be to consolidate the fragmented interests of a factional party by requiring all the members to support the same package of legislation and prohibiting them from promoting independent legislation. The provisions in Indiana's 1851 constitution created such a secondary rules when it required the legislature to pass general laws for 17 specific government functions, pass general laws for all functions whenever possible, create general laws for chartering corporations, and forbade incorporation by "special" act that only applied to one corporation.<sup>16</sup> Such an impersonal rule provision is completely consistent with the logic of coordinating organizations in a rosette world. It is a secondary rule for the coordinating organization, in this case the legislature, while it need not be a rule for the member organizations, the local political organizations. In order to satisfy the participation constraint all that is required is that the members of the legislation are made better off by the rule. It is a rule

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<sup>16</sup>See Lamoreaux and Wallis, 2021 for the Indiana history.

that the member organizations can require of the coordinating organization. For them to sustain the impersonal provision the participation constraint must be met through time as well.

However, the possibility of a legislature in an identity rule society adopting such a secondary rule is severely constrained by several factors that we have already identified in the logic of the natural state. If identity rules are used to make agreements between powerful organizations in the society credible, such a change in the secondary rules would never occur. If such a secondary rule was, by accident, created and enforced, social order would quickly begin to break down as intra-elite agreements that used identity rules created by the legislature as external rules to coordinate their internal organizations, as well as intra-organizational relationships, would no longer be credible. The third reason is simply the difficulty of coming up with the concept of an impersonal rule provision in a society where there had never been such a rule before, when the normal course of rule making produced identity rules, and beliefs that identity rules were an important source of social order were widely held.<sup>17</sup> Who would think of such an idea?

No one, apparently, thought of the idea before the middle of the 19<sup>th</sup> century. Indiana in 1851 did not adopt its impersonal rule provision for the reasons I have just given, it did so because of idiosyncratic and contingent set of events that had occurred in the 1830s and 1840s when the state borrowed a substantial amount of money in 1836 to begin building a canal system. The state was ultimately forced to default on its debts in 1841. There is no evidence that

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<sup>17</sup>That intellectuals, political theorists, and elites in general did hold such ideas see the introduction and papers in *Organizations, Civil Society, and the Roots of Development*, Naomi R. Lamoreaux and John Joseph Wallis, Chicago: NBER/University of Chicago Press, 2017. The chapter by Jacob Levy is particularly relevant to the intellectual environment in the late 18<sup>th</sup> and early 19<sup>th</sup> century regarding the possibility of impersonal rules.

the Swedes adopted the Handwerksordnung Ordinance in 1846 to solve the internal problems of their political parties, or that the Danish courts (and Norwegians who were then a colony of Denmark) adopted the idea of open access to legal personhood in 1826 for political reasons. A series of different random events occurred in different places that led to political systems gaining some experience with impersonal rules and, sometime in the middle to late 19<sup>th</sup> century, enterprising politicians began applying the lesson to the organization of their own parties and, in turn, to their political systems.

Naomi Lamoreaux and I have a paper explaining how the Republican Party in Pennsylvania pushed for a constitutional convention in 1873 to include an impersonal rule provision similar to Indiana's, for the primary reason of enabling the Republican Party to more effectively organize the internal factions within their party that threatened their majority. The Republicans were the majority party in Pennsylvania after the Civil War, but their majority was thin and the internal factional division fierce. But the move to an impersonal rule provision worked to consolidate the Republican party in Pennsylvania by limited the ability of individual legislators to introduce and pass private, special, and local laws. The constitution change created an external rule in the legislature that the Republican political organization, just a part of the legislature, was able to use the provision to mitigate the fundamental tension within its ranks. It worked.

Although in Pennsylvania the initial impetus to adopt an impersonal rule provision came from the Republicans, in other states it came from the Democrats. Yet in every state, when the incumbent majority party lost its majority, the new majority party then benefitted from the party

cohesion that impersonal rules provided. The opposition would not repeal the rules when they came to power.

Although the terms and historical setting are different, this argument is consistent with Gary Cox's explanation of the development of permanent consolidated political parties in Britain in the second half of the 19<sup>th</sup> century in *The Efficient Secret*. By the end of the 19<sup>th</sup> century on both Britain and the United States, two consolidated parties had replaced the factional parties that dominated the early 19<sup>th</sup> century in both countries. Daniel Ziblatt compares Britain and Germany in the late 19<sup>th</sup> and early 20<sup>th</sup> century and shows how the failure of the German political parties to consolidate contributed to the loss of democracy in Germany in the 1930s.

#### *4.3 Impersonal Rules and Political Outcomes: The Second Question*

While this answers why some political systems began to adopt impersonal rules in the 19<sup>th</sup> century, it is only a small part of the answer to the second question: how are impersonal rules sustained politically after they are first adopted? It is only a small part because in order for all of the major parties in a political system to be well organized and durable through time, it must be the case that *all of the parties foreswear the use of identity rules* to harass, suppress, or eliminate opposition parties when they are in power. If a party gains a majority and decides to violate the impersonal rule provision in order to eliminate the opposition, that gives its members a wonderful short term reason to band together, for if they do not hang together they are certain to hang separately.

A stronger set of incentives for parties to honor the impersonal rule provision can be created through a set of interacting rules. Again, the logic is the same as in Figure 1. The

member organizations utilize the creation of rules in the coordinating organization to help them mitigate the fundamental tension in their organizations. Here, however, it is the fundamental tension that exists within the parties that make up the rule and organization field of the political system, as well as tension between the parties. In a factional party system, individual legislators and members of factions are constantly finding that their interests are not best served by staying in their current party, and so they shift to a competing party. The result is many small, short lived parties.<sup>18</sup> This is the fundamental tension and participation constraint writ large in the clearest possible terms. How can the parties collectively prevent one of their members from defecting from the agreement to formulate only impersonal rules? How can the members of the all the party organizations come to believe that the agreement about impersonal rules will not be eroded by political relationships in the future?

Remember that member organizations shape the rules and agreements that coordinating organizations can create and enforce. Legislatures are coordinating organizations for the political parties within the electoral system, even as legislatures are organizations with much wider functions. Political organizations exist to control or influence governments, governments that are coordinating organizations with a society. Just as with the simple rosette world example of Figure 1, the member organizations (the factions) come together to form the coordinating organization (the legislature). They shape the agreed upon rules in the coordinating organization to improve their internal relationships, subject to the participation constraint. All of the factions

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<sup>18</sup>In the last two elections in Brazil, for example, there were over 20 parties in each election.

that coordinate through the legislature and government must benefit from belonging.<sup>19</sup> Using the secondary rules of the coordinating organization, the member organizations can change the external rules created by the coordinating organization to better order the member organization's internal relationships. This is what the adoption of impersonal rules in the legislature (the coordinating organization) accomplished in Pennsylvania for the member organizations (the political parties),

One of the features of consolidated party systems in developed democracies is the presence of a small number of durable major parties, parties with a reasonable chance of winning elections or participating in governing coalitions, that compete repeatedly in open and free elections. Depending on the electoral rules adopted, the system may be characterized by two major parties, as in the US and UK and their first past the post systems, or multiple parties with coalition governments, as in much of Europe with their proportional representation systems. One of the features of party systems in the factional party systems of the developing world are many, small, short lived factional parties (as just discussed in identity rule regimes).<sup>20</sup> We can ask how factional parties with short expected lives come to believe that they can lose an election today and be able to compete in elections in the future?

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<sup>19</sup>If a significant interest does not benefit from coordinating through the legislature and it withdraws from the agreement, secession and civil war become a real possibility.

<sup>20</sup>There is a growing literature on the organization of party systems outside of the developed world. The consensus is that those party systems are factional, made up of many small, ever changing parties. For an introduction to the literature see Scott Mainwaring and Timothy R. Scully, 1995, *Building Democratic Institutions: Party Systems in Latin America*, Stanford: Stanford University Press; and for rich citations to the emerging literature, see Scott Mainwaring, Ed. 2018. *Party Systems in Latin America: Institutionalization, Decay, and Collapse*. New York: Cambridge University Press. For Africa see Rachel Beatty Reidl (2014) and for South Asia see



Sustaining a political system where parties have more durable lives requires that politicians themselves develop expectations that parties will be around longer in the future. We can use that feature to reverse engineer our thinking. What will politicians and parties have to see to believe that parties are credibly durable? Politicians and political organizations collectively control the rule creation process. Conceptually, what set of agreed upon rules could be enacted within a legislature (or constitutionally) to guarantee parties would have longer lives? The agreements involve three elements, three sets of agreed upon rules, all within the control of the political organizations who make up the legislative and political process. The three elements are competitive elections, constitutional changes in government administration, and impersonal rules. Together these three sets of institutional rules create a *party system* capable of sustaining durable long lived political parties. The party system of durable consolidated political parties is an outcome of these three elements, but is usually regarded as a fourth democratic element itself.

*Competitive elections:* durable parties have to believe when they lose an election that they will be able to return and compete in an open and fair election in the future. Ultimately, free, fair, and open elections require rules under which voters are allowed to cast their ballots without undue outside influence. Sustaining competitive elections also involves parties forswearing the use of violence as an electoral technique, either against other parties or directly threatening voters. In a party system where elections are competitive and open, major parties know they will lose elections in the future, but existing parties can also believe they will have a chance to compete in future elections even if they lose the current one.

*Constitutional arrangements for government administration:* All parties must agree to changes in constitutional structures so that the leaders of government organizations, such as

cabinet ministers, are either directly subject to election or are appointed and easily removed by elected officials. The selection of the leaders of government organizations must depend on elections. Elections must matter to governments and elections matter much less if control of the government lies outside of the electoral system, say with the king. By placing control of government administration with elected officials, political party leaders became both government officials when their parties were in power, and party officials when their parties were out of power. Robert Dahl described this as a system of *reciprocal control*. The parties put themselves under the discipline of elections, and insure that the parties that win elections have access to positions of control within the government.<sup>21</sup> How then was the winning party to be prevented from using its control of the government and legislature to change the rules in order to suppress or eliminate the losing parties?

*Impersonal rule provisions:* Since the party that wins an election has disproportionate influence over the legislative process and the formation of new rules, all parties have to agree that whatever rules they pass when in power apply equally to everyone. The party in control cannot pass identity rules that discriminate against or suppress the parties out of power. A firm commitment to impersonal rules insures that when a party loses an election it is capable of competing again in the next election. Support for impersonal rule provisions must be baked into

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<sup>21</sup>In Dahl's *Polyarchy*, which lays out the elements of political systems as they develop toward democracy, the last element is "8. Institutions for making government policies depend of votes and other expressions of preferences." (1971, p. 3) See Robert Dahl. 1956/2006. *A Preface to Democratic Theory*. Chicago: University of Chicago Press, for a discussion of reciprocal control in the ideas of James Madison. I have lifted the term out of context, but not, I hope, out of substance. "Madison evidently had in mind a basic concept, namely, that of reciprocal control among leaders." p. 21.

the institutional agreed upon rules that structure the party system. All the organizations with a legitimate chance to control the legislative process and the government must have clear incentives to support and sustain impersonal rules.

The three democratic elements of the agreement the parties reach can be institutionalized in agreed upon rules passed by the legislature or embedded in constitutions. Perhaps unexpectedly, the new party systems that emerge in consolidated democracies do not need to include much in the way of rules about the formation and operation of political parties themselves, indeed they probably cannot. Any rules about parties could be used to adversely affect some parties over others.<sup>22</sup> Instead of rules about parties, the party system creates rules about elections, government administration, and impersonal rule provision that are external to the parties themselves. The agreed upon external rules create assurances and incentives for parties to become more durable through time, to abide by the results of open and competitive elections, and to continue to sustain impersonal rule provisions. In this way, the government comes under the reciprocal control of organizations that have a strong and abiding interest in maintaining competitive elections and impersonal rules.

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<sup>22</sup>This does not mean there are no rules about parties. Holding competitive elections requires rules governing how candidates are able to get their names on the ballot, how the ballots are structured, and rules like that may include provisions that directly affect parties. There are, however, no rules mandating the organizational structure of parties that parallel the rule governing the structure of economic organizations, for example. It means that the parties are largely “extralegal” organizations. Schattschneider put it this way: “The extralegal character of political parties is one of their most notable qualities. In a highly legalistic system of government such as the United States, therefore, the parties seem to be a foreign substance. It is profoundly characteristic that the fundamental party arrangements are unknown to the law.” (1942/2004, p. 11)

The fourth democratic element, durable consolidated political parties, which are an outcome that depends on the presence of the other three elements, but is often treated as a freestanding democratic element of its own. We can examine the historical record to see whether the societies that adopted modern consolidated democracies embodied the four democratic elements, and we will shortly.

But first we need to modify Figure 1/5 to reflect the organization of a the political rule and organization field in a consolidated democracy, as shown in Figure 6. The figure is drawn to represent a polity with two major parties, P1 and P2. It could be drawn with more major parties as in a proportional representation system with a governing coalition of major parties. There are still powerful elite organizations represented by ellipses, but now the two political parties reach into the solid circle in the middle of the rosette: the government. In Figure 1 and 5 there is a coordinating organization in the center of the inner loop, but not necessarily a government. In Figure 6 the two political parties exert reciprocal control over the coordinating organization: the government. In the Figure, one of the two parties at any point in time, P1 or P2, controls the government as indicated by the party ellipses intersecting the government circle. Both parties are involved in government administration, but the party that wins elections controls specific parts of the government. The only feasible way to get control of the government within the existing agreed upon rules is through the major parties. The figure is too simple, there is only one government and one political field, when in an actual society there would be fields of political fields. But the logic of a consolidated democratic polity, with two consolidated major parties, is easily represented in terms of a rosette world.

I know from experience that the figures seem awkward and artificial to most people upon first viewing. Nonetheless, the shared feature of all the figures from Figure 1 to 6, is that rules and organizations are intimately connected through external rules. The institutional structure of any society, when institutions are defined as agreed upon rules, can be represented as a rosette world. What differs across societies is the *type of external rules that connect the elements of the rosettes*. How are the organizations of a society organized with respect to one another? What are the coordinating organizations and how are they connected to member organizations and to each other? Those are common elements of rules, organizations, coordinating organizations, and governments in all human societies. The rules in every society vary along the four characteristic dimensions – primary and secondary, internal and external, prescriptive and default, and identity and impersonal rules. In every society the rule environment is conditioned by the necessity to mitigate the fundamental tension between rules and relationships, and by the participation constraint. Relationships make societies go, rules either help or hinder the extent to which societies are able to coordinate between heterogeneous individuals and organizations, and so are a basic determinate of the productivity of a society's economy and the stability of its political system.

Part Two of the book examines how institutional structures developed in the European societies that attempted to implement some form of democratic institutions in the 19<sup>th</sup> century. The details will be summarized in a few pages, but the key result is that the societies that adopted impersonal rules as the adopted democratic reforms, built democracies that persisted. The countries that did not adopt impersonal rules as they adopted democratic reforms – Germany, Italy, Austria, Spain, and Portugal – all lost their democracies in the 1920s and 1930s.

Addendum:

Note how different these institutional elements are from how the institutional explanations of economic development traditionally are structured. Here is how Acemoglu, Johnson, and Robinson characterized good institutions in 2002:

“As we discuss in more detail below, we hypothesize that a cluster of institutions ensuring secure property rights for a broad cross section of society, which we refer to as institutions of private property, are essential for investment incentives and successful economic performance.” (AJR, 2002, pp. 1235. Italics in original)

“In this context we take a good organization of society to correspond to a cluster of (political, economic, and social) institutions ensuring that a broad cross section of society has effective property rights. We refer to this cluster as *institutions of private property*, and contrast them with *extractive institutions*, where the majority of the population faces a high risk of expropriation and holdup by the government, the ruling elite, or other agents. Two requirements are implicit in this definition of institutions of private property. First, institutions should provide secure property rights, so that those with productive opportunities expect to receive returns from their investments, and are encouraged to undertake such investments. The second requirement is embedded in the emphasis on “a broad cross section of the society.” A society in which a very small fraction of the population, for example, a class of landowners, holds all the wealth and political power may not be the ideal environment for investment, even if the property rights of this elite are secure. In such a society, many of the agents with the entrepreneurial human capital and investment opportunities may be those without effective property rights protection. In particular, the concentration of political and social power in the hands of a small elite implies that the majority of the population risks being held up by the powerful elite after they undertake investments.” (AJR, “Reversal of Fortune,” *QJE*, 2002, pp. 1262-3. Italics in original)

This is a description of institutional outcomes, but it does not tell us where the institutions come from and how they are sustained. Only that some institutions are associated with better social outcomes than others.

### *5. Stability and empirical evidence*

Part Three of the book brings together some pieces of empirical evidence that bear on the concepts and arguments just briefly presented. The presentation of the empirical evidence here will be equally brief.

The earlier discussion emphasized the effects of impersonal external default rules on heterogeneity as a source of productivity growth, and postponed a discussion of the effects of default rules on stability. Both economic and political stability concern us here. Economic stability can be measured by variations in the rate of economic growth, the simply whether real per capita income is growing or shrinking from year to year. Political stability can be measured as the frequency of changes of governments, regime changes, that are “irregular,” that is, regime changes that do not follow agreed upon rules for changing governments. When a new administration is elected in the United States that is a regular regime change. When a coup in Sudan or Haiti occurs, that is an irregular regime change. Irregular regime changes are caused by civil wars, coups, other irregular changes, and I also include new constitutions as an irregular regime change (as new constitutions introduce changes in the basic primary and secondary rules).

Impersonal external default rules have direct effects on both economic and political stability. The world is a constantly changing place, and it changes unpredictably. As circumstances change, relationships between individuals, between organizations, and between organizations and individuals will change as well. The fundamental tension is always at work! If relationships are supported by impersonal external default rules, however, the relationships can change their form and structure without necessitating a change in the agreed upon rules that

support the relationship, as the same default rule can serve as an outside option for many heterogeneous forms of relationships.

On the political side, if a coordinating organization provides external *identity* rules, be they prescriptive or default rules, when circumstances change and intra-elite arrangements need to be adjusted the rules will need to change. Even if the form of the rule doesn't change, the identities associated with the rule have to change. If a coordinating organization provides impersonal external *prescriptive* rules and circumstances change, the rules will have to be changed or they will be ignored or repealed. A coordinating organization that provides impersonal external default rules enables its member organizations to be more flexibly enabled to cope with changes in circumstances by accommodating changes in behavior that do not have to follow the rules and, therefore, they do not have to change the rules as frequently.

The question naturally arises, are impersonal rule societies more stable both economically and politically? Here we will take 18 countries that make up the modern developed world (not including Japan and South Korea) in comparison to the rest of the world. The countries are listed in Table 5 and in the notes to Table 2.

Broadberry and Wallis (2024) examine the effect of instability on long term economic growth. They make use of an identity for establishing the contributions of growing and shrinking to long run economic performance. Long run economic performance can be measured by the rate of change of per capita GDP over periods of fifty years or longer. Economic performance over this time frame is the aggregation of short run changes measured at the annual level. Long run economic performance,  $g$ , is a combination of 4 factors: (1) the frequency with which an economy grows,  $f(+)$  (2) the rate at which it grows when growing, or the growing rate,



$g(+)$  (3) the frequency with which an economy shrinks,  $f(-)$  and (4) the rate at which it grows when shrinking, or the shrinking rate  $g(-)$ . Thus:

$$g = \{f(+)\ g(+)\} + \{f(-)\ g(-)\} \quad (1)$$

Since the frequency of growing is equal to one minus the frequency of shrinking, equation (1) can be rewritten as:

$$g = \{[1-f(-)]\ g(+)\} + \{f(-)\ g(-)\} \quad (2)$$

which reduces the number of independent factors to three. We can use this identity to decompose long run economic performance into shrinking and growing components. The growing component is the growing rate times the growing frequency and the shrinking component is the shrinking rate times the shrinking frequency. Using simple arithmetic, we can show that better long run economic performance occurred not so much because of an increase in the growing rate, but more because of a reduction in the rate and frequency of shrinking.

Table 1 shows the frequency and rate of growing and of shrinking, as well as the contributions of growing and shrinking, between 1950 and 2008, by levels of country income in 2000 dollars. Table 2 shows how the frequency and rate of growing and shrinking in the 18 countries of the developed world of 2024, at intervals from 1820 to 2008. In panel 2C, the frequency of growing and shrinking is interacted with the growing and shrinking rates to produce the contributions of growing and shrinking to long run economic performance, as measured by the average rate of change of per capita income in all years. This makes clear that the improvement in economic performance during 1950-2008 compared with earlier periods can be attributed mainly to a reduction in the contribution of shrinking, since the contribution of growing either stagnated or actually declined slightly in most countries. The simple

growing/shrinking comparison across the earliest and latest time periods, 1820-1870 and 1950-2008, from Table 2C shows that growing accounts for 21 percent of the increase in the rate of change of per capita income of 1.15 percent, from 1.40 in the early period to 2.55 in the later period,  $((2.72-2.47)/(2.55-1.40))$  while shrinking accounts for 79 percent of the increase  $((-0.16-(-1.08))/(2.55-1.40))$ . The reduction in the rate and frequency of shrinking is roughly four times more important than the increase in the rate and frequency of growing in the countries of the developed west between 1820 and 2008.

Roughly 80 percent of the growth of real per capita income in the developed world between the beginning of the 19<sup>th</sup> century and the end of the 20<sup>th</sup> century can be explained by increasing economic stability, by a reduction in the rate and frequency of economic shrinking. None of the growth of per capita income can be explained by an increase in the growing rate of when economies are actually growing, because over those two centuries the growing rate in the developed world has actually declined.

What about political stability? Tables 3 and 4 present information broken down by income actualise rather than income levels. The 22 high income countries make up the top income octile, and that group is roughly the OECD countries, including all the 18 countries in the Table 2, which is why binning the data by actualise was chosen. The frequency of irregular political regime changes is given for each octile in the third column. In the poorest countries, irregular regime changes occur, on average, every four years (a frequency of .25). Even up to the sixth octile the frequency of irregular regime change implies, on average, an regime change every 11 years (a frequency of .09).

In contrast, in the richest octile, the frequency of irregular regime changes rounds to zero.

It is actually .003, and the three changes are all new constitutions. What is remarkable about the numbers in the table are not the high rates of political instability in most nations of the world, what is remarkable it is the incredibly stable political arrangements in the richest octile of countries. That is what we need to explain if we want to explain modern economic and political development. If we take the experience of the developed countries since 1950 as normal, and take the experience of the rest of the world as deviating from the norm (e.g. because of corruption or culture), then we are doomed. We cannot explain what is normal by focusing on what is abnormal, and the developed world is historically and empirically abnormal.

#### *4.2 Political Stability, Consolidated Political Parties, and the Institutional elements of Developed Democracies*

One of the central features of developed democracies is consolidated party systems: a small number of major parties compete regularly in open and fair elections for control of the government. The winning party, or winning coalition of parties, gets control of the government and, subject to the relevant constitutional limits, pursues policies and enacts rules as it is able to within the secondary rules, subject to the constraint that most rules must be impersonal. A logic of how political parties could come to expect that they could lose elections and return to compete again was developed in section 3. It had three, or four, institutional elements (three if you count durable parties as an outcome and four if you count durable parties as an element). In a straightforward way, durable and stable political parties and party systems are major contributors to the stability of the overall political system that we just looked at.

All 18 countries began developing elements of democracy in the 19<sup>th</sup> century (or a bit

earlier), and the countries listed in Table 5 are all high income countries with consolidated democracies today. But five of the countries lost their democracies completely after 1920: Germany, Austria, Italy, Spain, and Portugal. One implication of the idea that the four democratic elements are necessary for political parties to believe that they can lose an election and return to compete in future elections is to track whether those 18 societies adopted the three institutional elements necessary for durable parties. Unfortunately, we cannot call on established histories to document when the societies that moved toward impersonal rules did so. But we know that creating impersonal rules for forming and operating organizations, like the *Handwerksordnung* ordinance in Sweden, led to a significant increase in the number of legally recognized corporations.

Table 5 sorts the 18 countries by the number of corporations per million inhabitants from Les Hannah's census of corporations in 1910 (2015). Columns (2) - (4) indicate whether a reform occurred in the elements of election laws, constitutional provisions about government administration giving control of the government to the winning party or coalition in an election, and whether there were impersonal rules for forming organizations. The upper panel of the table include countries that adopted all three democratic institutional arrangements, had more corporations per million inhabitants, and kept their democracies after 1920. Belgium and France, in the third panel, are on the cusp. Countries in the lower two panels adopted some elements of democracy, like elections or universal suffrage, but did not adopt any of the three specific democratic elements. The countries in those two panels had fewer corporations per million inhabitants, and all five lost their democracies after 1920 altogether. Appendix Table 1 provides more detailed documentation of when countries did or did not adopt the democratic

elements, but that is too much detail for this introduction.

#### 6. *Wrapping up and moving forward*

This paper is an introduction to the ideas, and a bit of the evidence provided in, *Leviathan Denied: Rules, Organizations, Governments and the Institutional Origins of Modern Democratic Capitalism*. The book has three parts.

The heart of Part One is the realization that the institutional literatures in economics, the social sciences, law, and philosophy have systematically equated collectively agreed upon rules with norms of behavior. This is conceptually problematic, since agreed upon rules result from deliberate collective decision within organizations to form rules, while norms of behavior emerge out of patterns of individual behavior that often, perhaps usually, are not the result of agreements at all. While both rules and norms affect individual choice in the same way, they are distinctly and substantively different social process and cannot be effectively lumped together in one theory of institutions and institutional change.

Moreover, and perhaps more important, norms only exist if they are followed: a pattern of behavior needs to exist before there can be a norm. H.L.A. Hart calls norms “convergent behavior” and throughout *The Concept of Law* he continually returns to the fact that norms of convergent behavior are not laws. Agreed upon rules do not have to work the way norms work. Many important coordinating rules adopted by organizations are default rules: rules that can be enforced if necessary but are not necessarily followed. These are rules that may not produce a pattern of rule following behavior. The usual motivation for how rules enhance coordination between people is that, if the rules are followed, people can confidently predict how other people

will behave, as a result default rules have no place in the institutional bestiary of types of rules.

If organizations are groups of people that adopt rules to enhance the value of their relationships with each other by facilitating coordination, and the purpose of agreed upon rules is to enhance the value of relationships, *then relationships will always be more important within organizations than rules*. If in some specific circumstance an agreed upon rule reduces the value of relationships, the rule will be ignored, abandoned, or changed. *Relationships drive rules*. The fact that rules are not followed may have nothing to do with cheating, corruption, or strategic behavior but simply that the members of an organization realize that following the rules will reduce the value of relationships within the organization. But since rules are more effective at coordinating if they are predictable, a rule that may or may not be enforced because of relationships will be a less effective coordinating tool. This fundamental tension between relationships and rules is well understood in the institutional literatures, but how organizations in human societies adapt to mitigate the effect of the fundamental tension by using external rules is neither well understood conceptually nor empirically.

With default rules, and particularly with impersonal external default rules, organizations effectively get to have their cake and eat it too. They are able to use predictably enforced agreed upon rules to credibly govern relationships, but they have the option of not accessing the rule from the coordinating organization.

If two or more organizations can agree to enforce rules for each other, or more generally if two or more organizations join together to create a third organization, then the “coordinating organization” can mitigate the effect of the fundamental tension if the coordinating organization is insulated from the relationships in the member organizations. Governments are, of course, the

iconic example of coordinating organizations: organizations that create and enforce rules that other organizations can use as external rules to better order their internal relationships. But organizations of organizations and coordinating organizations exist throughout any large society. There are always multiple rule givers, multiple coordinating organizations, and multiple governments.

All of the rules matter, not just the government's rules. The rules that really matter for enhancing coordination in a society are not the government's or the coordinating organization's rules, but are the primary rules within the organizations of a society. These are the rules that affect the relationships that determine how productive organizations are at creating value, however that value is produced. Those organizations are governed by internal rules that are enhanced or retarded by the external rules. The external rules may not facilitate coordination by themselves, but if they enhance the primary rules that do facilitate coordination, then the external rules help determine how well the society performs economically as well as politically.

Understanding how internal and external rules affect one another is, therefore, critical to understanding how institutions actually work. Very often external rules are better at coordinating if they are default rather than prescriptive rules, something the institutional literatures have simply not taken account of, much less come to grips with understanding in any meaningful way. Moreover, external default rules are often more powerful at enhancing coordination within organizations if they are impersonal rules that apply to all citizens, or to all members of large classes of people.

A great deal of the literature on modern development and the failure of many societies to develop, focuses on the inability of governments to credible commit to enforce rules in an

unbiased way, on the lack of rule of law, and on corruption. The underlying assumption is that *economic development is frustrated because the rules are not followed*, either by the politicians who make the rules, the government officials who enforce them, or the private organizations that use the rules to coordinate.

This approach to the sources of development misses completely the significant number of rules and laws in developed societies that are enforced, *but not followed*. It is not rule following itself, or active unbiased enforcement of rules or laws, that produces modern development. Real societies are never societies with just one government whose rules govern all the relationships, individuals, and organizations in the society. Real human organizations always face the fundamental tension between relationships and rules, and real human societies mitigate the tension and make their organizations and their relationships more valuable more utilizing external rules. The result is rules at every level of organization in a society, is rosettes of rules and organization in constant interaction with one another. Until we understand how those interactions work, we will never understand how modern development occurred in a handful of societies and why it has not yet occurred in most societies. How to think about how societies work, the institutional structures of societies, is what this book is really about. Better understanding how modern development occurred is an example of the theory of institutions-as-agreed-upon-rules.

Mancur Olson built his argument in *The Logic of Collective Action* on the participation constraint: the logical, neoclassical assumption that people would not belong to an organization unless belonging made them better off, if they got rents that they could only receive from belonging. Hence the free rider problem. But Olson took the rule environment for granted and



he did not imagine that organizations could interact in ways that made their internal arrangements, their selective incentives, more credible and resilient. Olson did not consider the fundamental tension. The fundamental tension is a fact of life, it exists in organizations whether people are rational or irrational, whether an organization faces a free rider problem or not. The fundamental tension is not a neoclassical assumption. I have tried to show how the fundamental tension shapes rules and organizations, and their relationships, *at all levels of societies*, from families to nation states. The participation constraint really matters, because it constrains the forms that organizations and rules can take. But it is the fundamental tension that drives institutions and institutional change.

The productivity of an individual organization depends on its ability to predictably enforce its internal agreed upon rules, an ability that is always threatened by the fundamental tension. The productivity of an entire society's economic organizations depends on the effectiveness of its internal and external rules, as well as the heterogeneity of the organizations within its organizations. This is just basic Adam Smith and the importance of specialization and division of labor. We should not just be trying to understand why good rules produce predictable homogeneous behavior. We need to understand what institutions, what agreed upon rules, produce the heterogeneous outcomes and heterogeneous behaviors that we associate with the liberties and freedoms of consolidated, impersonal rule, democratic, capitalist societies.

**Table 1: Penn World Table 8.0: Growing and shrinking of countries by income categories, 1950-2011*****A. Average growing and shrinking rates and their frequency***

Per capita income in 2000	Frequency of growing years	Average growing rate	Frequency of shrinking years	Average shrinking rate
Over \$20,000	0.84	3.85	0.16	-2.22
\$10,000 to \$20,000	0.80	4.85	0.20	-4.25
\$5,000 to \$10,000	0.78	5.15	0.22	-4.89
\$2,000 to \$5,000	0.72	4.72	0.28	-4.29
Less than \$2,000	0.62	3.99	0.38	-4.32

***B. The contributions of growing and shrinking to economic performance***

Per capita income in 2000	Contribution of growing (frequency*rate)	Contribution of shrinking (frequency*rate)	Net rate of change of per capita income
Over \$20,000	3.23	-0.39	2.84
\$10,000 to \$20,000	3.82	-0.88	2.94
\$5,000 to \$10,000	4.00	-1.13	2.87
\$2,000 to \$5,000	3.30	-1.27	2.03
Less than \$2,000	2.47	-1.65	0.82

Sources and notes: Penn World Table 8.0, <http://www.rug.nl/research/ggdc/data/pwt/pwt-8.0>. The “Real GDP per capita (Constant Prices: Chain series)” and their calculated annual growth rates for that series “Growth rate of Real GDP per capita (Constant Prices: Chain series)” were used to construct this table. Countries were first sorted into income categories based on their income in 2000, measured in 2005 dollars. Average annual positive and negative growth rates are the simple arithmetic average for all of the years and all of the countries in the income category without any weighting. The Penn World Table includes information on 167 countries. The sample runs from 1950 to 2011, although information is not available for every country in every year. Countries are included only where information is available at least as far back as 1970, resulting in a sample of 141 countries.

**Table 2: Growing and shrinking in 18 European and New World countries, 1820-2008**

<b><i>A. Frequency of growing and shrinking</i></b>				
	1820-1870	1870-1910	1910-1950	1950-2008
Growing	0.66	0.67	0.65	0.88
Shrinkin	0.34	0.33	0.35	0.12
g				
<b><i>B. Average rate of change of per capita income in all years, growing years and shrinking years</i></b>				
	1820-1870	1870-1910	1910-1950	1950-2008
All years	1.40	1.31	1.23	2.55
Growing	3.88	3.16	5.20	3.06
Shrinkin	-3.04	-2.30	-6.10	-1.23
g				
<b><i>C. Contributions of growing (frequency*rate) and shrinking (frequency*rate) to long run economic performance (average rate of change of per capita income in all years)</i></b>				
	1820-1870	1870-1910	1910-1950	1950-2008
All years	1.40	1.31	1.23	2.55
Growing	2.47	2.10	3.33	2.72
Shrinking	-1.08	-0.79	-2.09	-0.16

Source: Derived from Maddison (2010). The included European countries are: Britain, France Italy, Belgium, the Netherlands, Switzerland, Austria, Germany, Portugal, Spain, Finland, Denmark, Norway and Sweden. The four New World countries are: the United States, Australia, New Zealand and Canada.

**TABLE 3: Rates of change of per capita income and frequency of economic and political instability sorted by income**

Income octile	Average rate of change of per capita income (1)	Frequency of economic shrinking (2)	Frequency of adverse political events (3)	N
<b><i>A: Sorted by income in 2010</i></b>				
Poorest	-0.02	0.43	0.25	979
	1.28	0.32	0.2	794
	1.47	0.28	0.24	836
	2.46	0.25	0.13	765
	2.32	0.24	0.15	863
	2.19	0.24	0.09	781
	2.79	0.24	0.06	869
Richest	2.48	0.15	0	969
Full Sample	1.85	0.27	0.14	6856
<b><i>B: Sorted by income in 1960</i></b>				
Poorest	2.06	0.28	0.26	600
	1.22	0.31	0.27	600
	0.78	0.4	0.15	550
	1.53	0.27	0.18	599
	2.23	0.22	0.21	599
	2.32	0.25	0.11	549
	2.21	0.2	0.05	600
Richest	2.19	0.17	0	550
Full Sample	1.82	0.26	0.16	4647

Sources and notes: Penn World Table 8.0; Archigos Dataset (Goemans et al. (2009); Comparative Constitutions Project (Elkins et al., 2022) The number of countries taken into account for statistics in Panel A is 171 and in Panel B is 93. In Panel A, the first octile corresponds to the poorest 12.5% of the countries according to incomes in 2010, while in Panel B it corresponds to the poorest 12.5% of the countries according to incomes in 1960.

**Table 4: Rates of change of per capita income and frequency of economic instability sorted by income**

Income octile	Average rate of change (%)	Growing rate (%)	Growing frequency	Shrinking rate (%)	Shrinking frequency
	(1)	(2)	(3)	(4)	(5)
<b><i>A: Sorted by income in 2010</i></b>					
Poorest	-0.02	3.93	0.57	-5.23	0.43
	1.28	3.8	0.68	-4.06	0.32
	1.47	4.3	0.72	-6	0.28
	2.46	4.94	0.75	-5.17	0.25
	2.32	4.36	0.76	-4.2	0.24
	2.19	4.5	0.76	-5.03	0.24
	2.79	4.87	0.76	-3.96	0.24
Richest	2.48	3.28	0.85	-2.01	0.15
Full Sample	1.85	4.22	0.73	-4.63	0.27
<b><i>B: Sorted by income in 1960</i></b>					
Poorest	2.06	4.59	0.72	-4.37	0.28
	1.22	3.77	0.69	-4.4	0.31
	0.78	3.98	0.6	-4.06	0.4
	1.53	3.8	0.73	-4.56	0.27
	2.23	4.07	0.78	-4.2	0.22
	2.32	4.41	0.75	-3.95	0.25
	2.21	3.5	0.8	-3.02	0.2
Richest	2.19	3.19	0.83	-2.68	0.17
Full Sample	1.82	3.9	0.74	-4.02	0.26

Sources and notes: Penn World Table 8.0; Archigos Dataset (Goemans et al. (2009); Comparative Constitutions Project (Elkins et al., 2022). The number of countries taken into account for statistics in Panel A is 171 and in Panel B is 93. In Panel A, the first octile corresponds to the poorest 12.5% of the countries according to incomes in 2010, while in Panel B corresponds the poorest 12.5% of the countries according to incomes in 1960.

**Table 5**  
**Corporations Per Million Inhabitants as Proxy for Impersonal Rules**  
**and whether a society adopted the three reform elements of**  
**Elections, Government Administration, and Expanded Impersonal Rules**

	Adopted Three Elements Before 1920?			
	Corporations Per Million -1	Electoral Reforms -2	Govt. Administration -3	Impersonal Rules for Organizations -4
USA	2913	Yes	Yes	Yes
Norway	2117	Yes	Yes	Yes
Canada	2032	Yes	Yes	Yes
New Zealand	1637	Yes	Yes	Yes
Australia	1545	Yes	Yes	Yes
Netherlands	1262	Yes	Yes	Yes
UK	1241	Yes	Yes	Yes
Switzerland	1060	Yes	Yes	Yes
Sweden	1055	Yes	Yes	Yes
Denmark	998	Yes	Yes	Yes
Finland	755	Yes	Yes	Yes
Belgium	561	Yes	Yes	Yes
France	306	Yes	Yes	Yes
Germany	403	No	No	No
Spain	106	No	No	No
Italy	78	No	No	No
Austria	70	No	No	No
Portugal	196	No	No	No

Note: the classifications of the three elements is based on my reading of the pluralist literature, including the case study chapters in Dahl, *Political Opposition in Western Democracies* (1966), the chapters in Lipset and Rokkan (1967) and LaPalombara and Weiner (1966); general histories of party development in Europe including Rokkan (1970) and Epstein (1967); individual case studies of the party systems in individual countries; and handbooks of electoral and governance institutions, including Carstairs (1980), Rokkan and Meyriat (1969), and Mackie and Rose (1991).

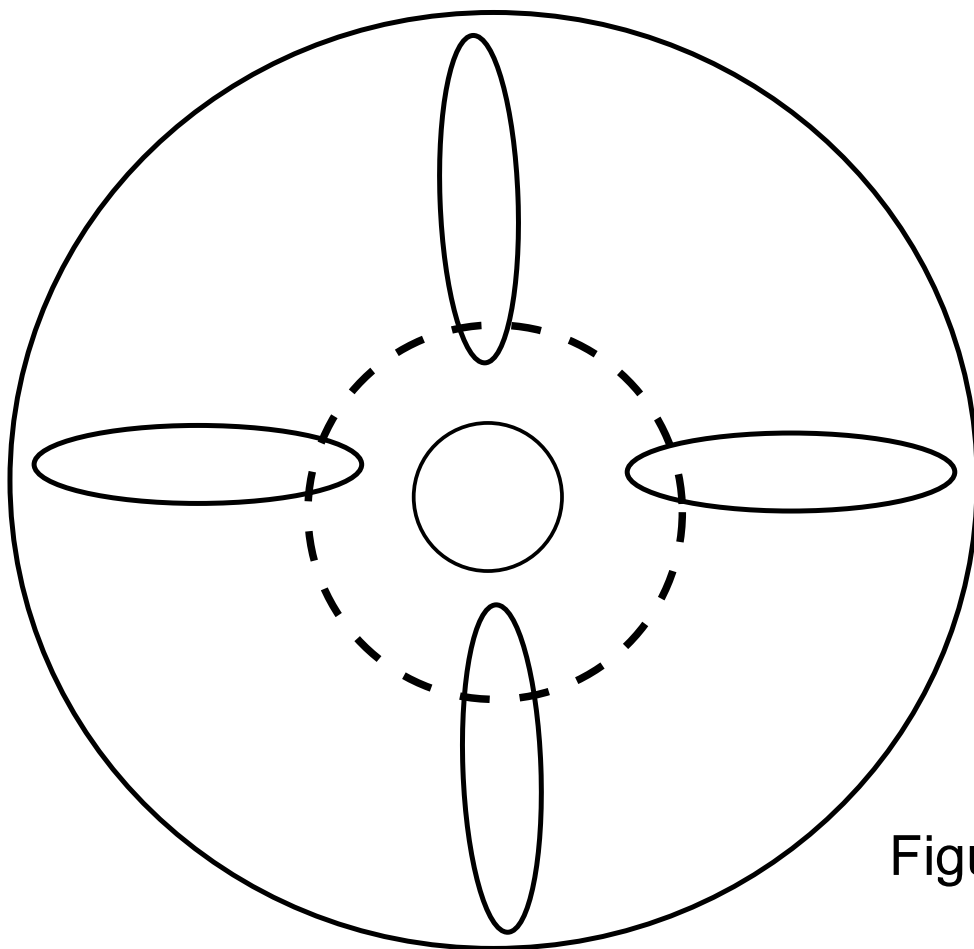


Figure 1

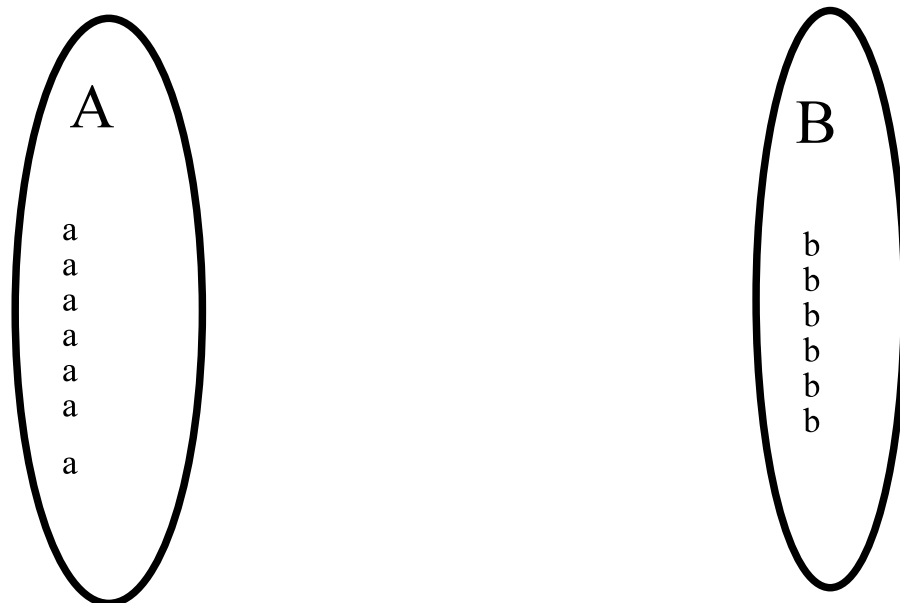


Figure 2



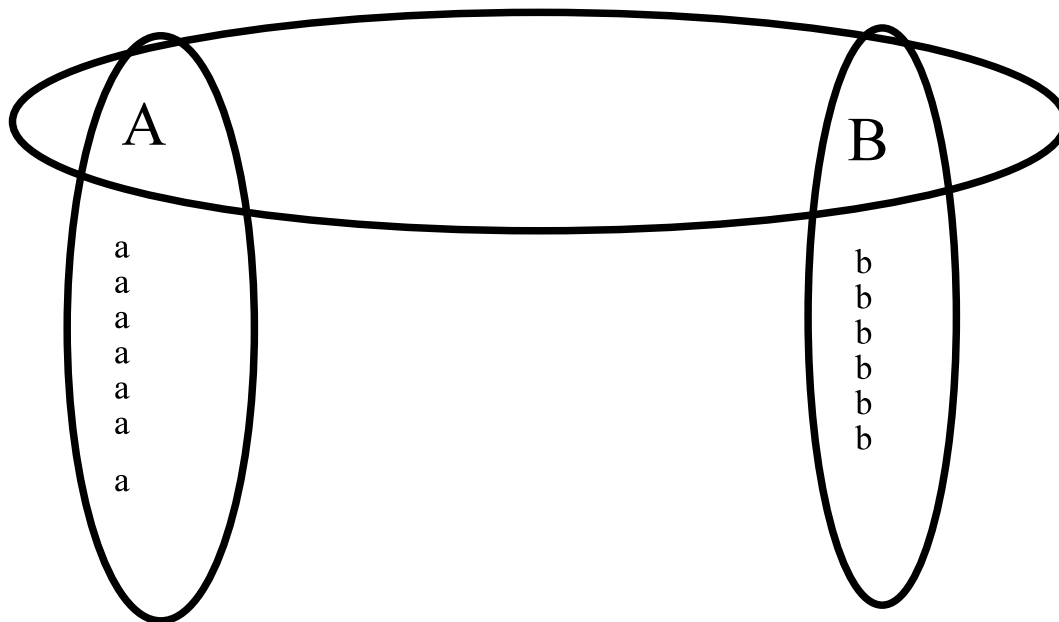


Figure 3

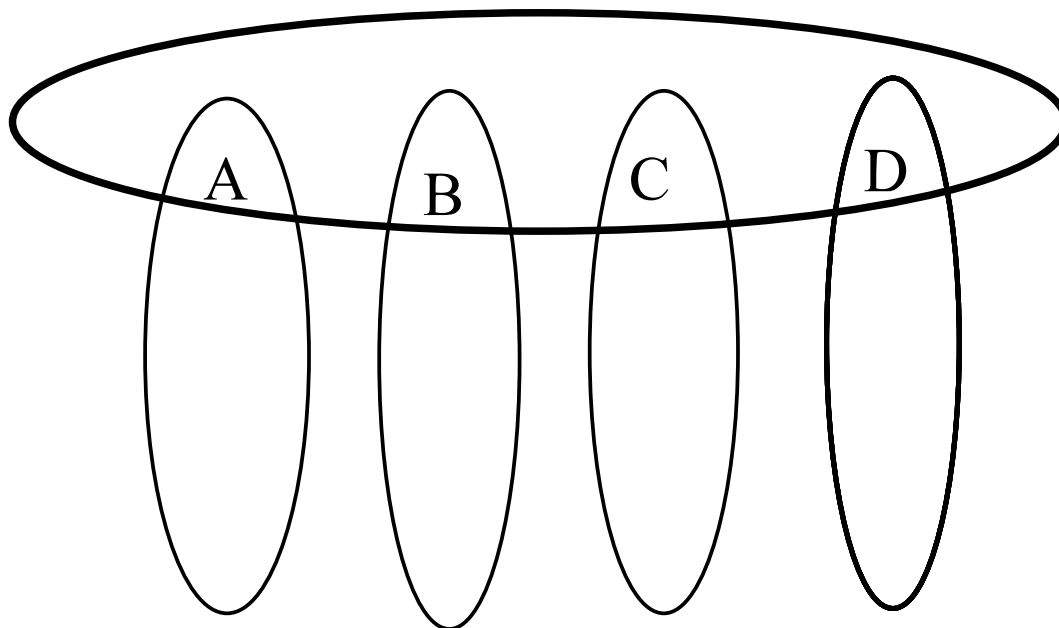


Figure 4

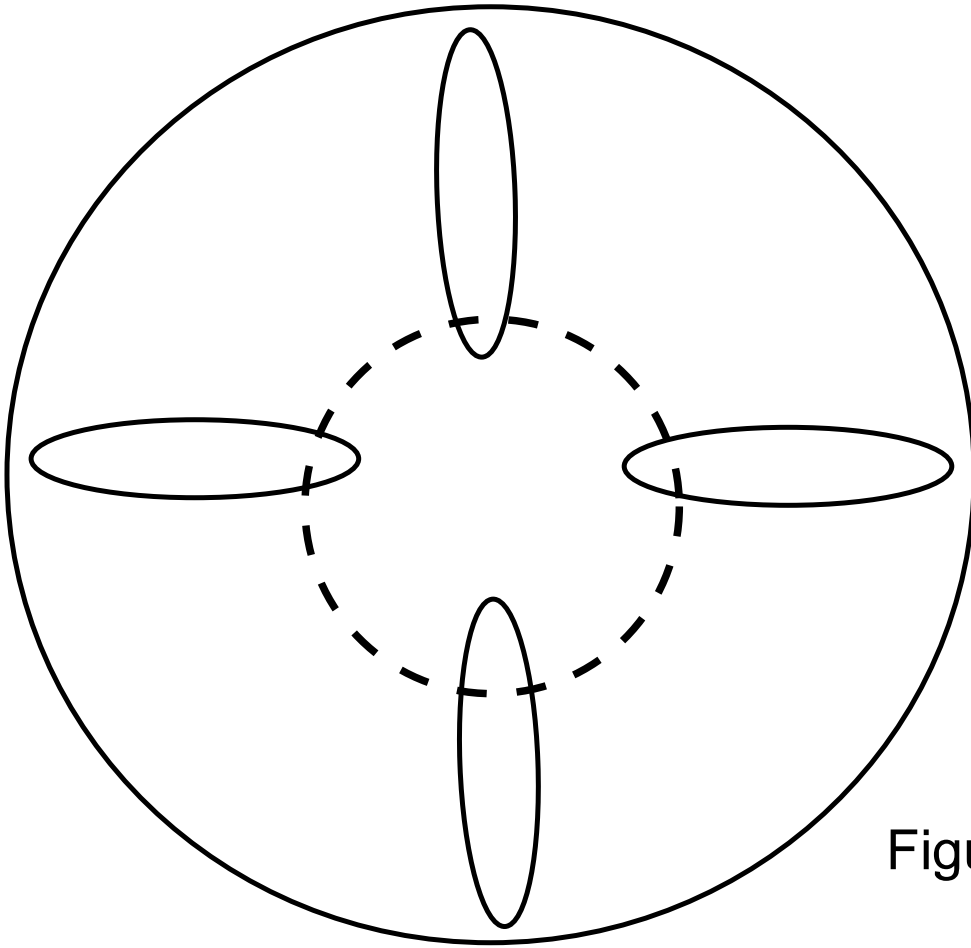


Figure 5

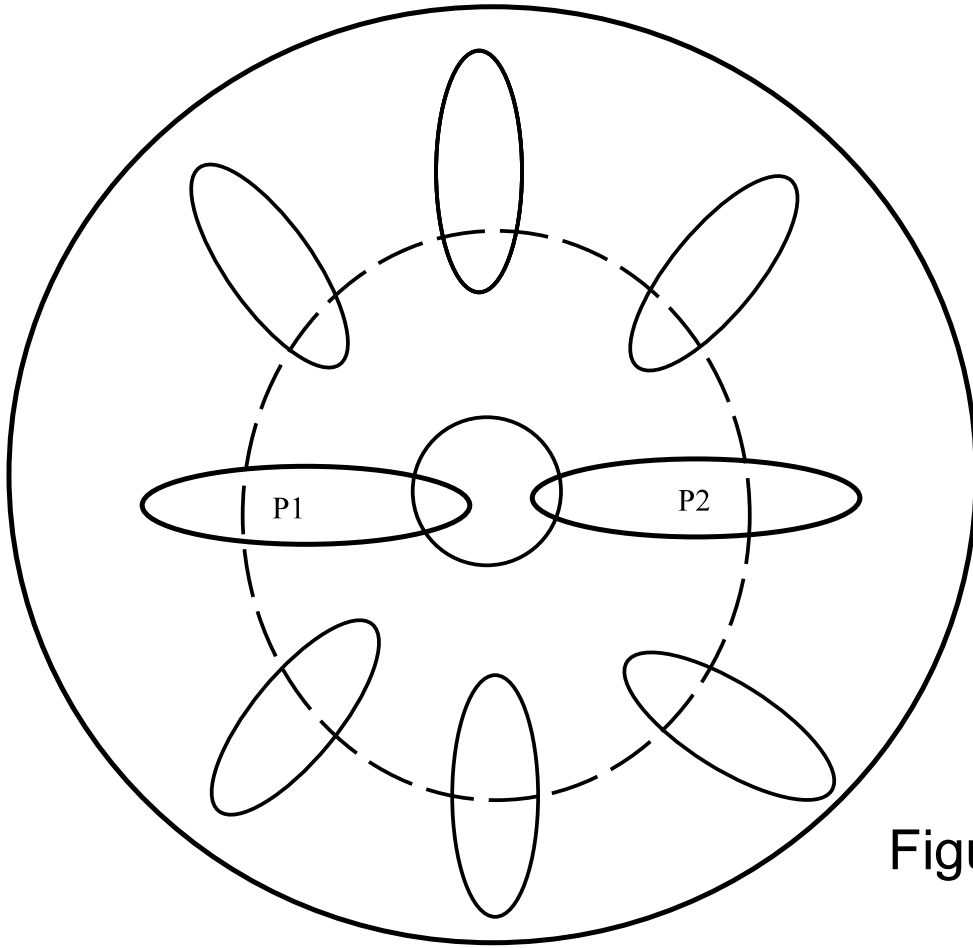


Figure 6

## Appendix Table 1

## Characteristic Features of European Democracies, 1800-1920

Panel A Country	(1) Electoral Winner Controls Govt	(2) Electoral Reforms	(3) Impersonal Rules for Organizations	(4) Consolidated Party Systems
Britain	Yes, after 1832 (?)	1832, 1867, 1870 1872 1883, 1884 1918	1844, 1856 Registration Acts	Yes, 1880s
United States	Yes, 1770s states <sup>7</sup>  Yes, 1789 national	1870s states Secret Ballot Anti-Fusion Laws 1965 national Voting Rights Act	1840s, 1851 (Indiana General Law Provision) By 1900, most states	Yes, 1870s, 1880s
Sweden	1902 Yes, 1917 <sup>1</sup>	1866 (secret ballot) 1911 (polling places) 1918-1921 (suffrage)	1846 (Association Law) Guild privileges abolished 1848 Companies Act, 1895, 1910	Yes, 1920s <sup>2</sup>
Netherlands	No 1815 Constitutional Monarchy Yes, 1848, 1868 <sup>3</sup>	1850,  1917 & 1919 (suffrage)	???	Yes, 1880s - 1917
Denmark	No, 1848 Constitutional	1849 Self Supporting Males over 30	1827 (Association Law)	Yes, 1870s <sup>4</sup>

2.LD.1.Intro.Harvard.24.4.19..24.4.11.wpd

Monarchy (King  
Head of Executive)  
Yes, 1901<sup>5</sup>

1901 Secret Ballot  
1915 (suffrage)

Panel B Country	(1) Electoral Winner Controls Govt	(2) Electoral Reforms	(3) Impersonal Rules for Organizations	(4) Consolidated Party Systems
Germany	No	1868, 1971 Universal Male Suffrage for Reichstag Ballot measures, 18XX (Mares)	1870, ADHGB 1892, GmbH 1908 1867, 1889 Cooperative Laws	No
Spain	No	Universal Manhood Suffrage 1869-1860, 1876-??, 1890, 1931	No	No
Austria	No, Under Hapsburgs Curial system of representation (abolished 1907) <sup>6</sup> Yes, 1919 Republic	1907 Universal Manhood Suffrage  1919 Universal Manhood Suffrage	No	No
Italy	No, 1861 Constitutional Monarchy	1912 Universal Manhood Suffrage	No	No

1 Sweden “This marked the final establishment of a government responsible to Parliament, only 12 years after the first serious contest between King and Parliament in 1902.” Carstairs, 1980, p. 101.

2 Sweden, By the 1920s a system of four dominant durable parties had emerged: “Although the riksdag since the early ‘twenties has included at times as many as seven distinct parties, only four of these have been represented continuously – the Social Democrats, Liberals, Agrarians (united in 1921), and Conservatives. In the next three decades these four major parties were to poll between 88.5 and 95.8 percent of the popular vote, to occupy between 93.5 and 98.7 of the lower chamber seats, and elect 96.7 to 100 percent of the senators. Sweden thus has had a four party system, and there have been no signs of any basic change in this situation.” (Rustow, 1955, p. 86)

3 Netherlands “Until the powers of Parliament had been asserted, first partially in 1848 and then decisively in 1868, there was little scope or need for party organisation, and political efforts were largely confined to the by liberals for constitutional reform.” Carstairs, p. 61. “The principle that the cabinet is entirely dependent on the confidence of parliament was firmly established in the protracted battle between the Second Chamber and the cabinet from 1866 to 1868. The Second Chamber repeatedly passed motions of censure against the cabinet and voted down the cabinet's budget proposals. The cabinet tried to maintain itself in office by twice dissolving the chamber, but the newly elected chambers still had strong majorities opposed to the cabinet. In the end, the cabinet resigned and was replaced by a new cabinet that had the chamber's confidence. Parliamentarism had triumphed.” (Lijphart, 1968, pp. 134-5)

4 Political parties in the modern sense began to appear in the 1870s with the liberal party group in Parliament.” Mackie and Rose, 1991, p. 88.

5 “In 1872 the Venstre gained a majority of seats in the Folketing [the lower house] and retained that majority for the rest of the century...Nevertheless, the King always appointed ministries which had Conservative support in the Landsting [the upper house, with indirect elections]... The Venstre reformers gained seventy-six seats and an absolute majority in the Folketing in 1901, compared with fourteen for the Social Democrats and eight for the Conservatives. The Social Democrats united with the Reform Venstre in demanding a parliamentary system in which the government would be responsible to the Folketing. The Crown capitulated, a Venstre government was formed in 1901, and the aim of responsible parliamentary government was at last achieved, more than half a century after attainment of universal male suffrage for the Folketing.” Carstairs, 1980, p.78.

6 “One of the inadequacies of the reform is that parliament had no control over foreign affairs and foreign policy.” Carstairs, 1980, p. 127. See Stiefbold and Metzler-Andlerberg chapter on “Austria” in Rokkan and Meylar, *International Guide to Election Statistics*, 1969, pp. 15-46.

7. Elections in the United States did not always directly elect government leaders. Today the electoral college is on paper an indirect way



of electing national presidents, even though in practice it is a direct election of the Executive, with different weights given to the votes of different states. Several early state constitutions had indirect election of governors, for example the upper house choosing the executive. By the 1830s those arrangements had largely changed to direct election of governors. Even so, all of the government offices at the state and national level were filled by the direct results of elections, or filled by appointment under the control of directly elected officials.

8. ADHGB: *Allgemeine Deutsche Handelsgesetzbuch*

GmbH: *Gesellschaft mit beschränkter Haftung*

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