

# Development and the Process of Constitutionalization<sup>\*</sup>

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## **Abstract:**

*In a recent contribution, North, Wallis and Weingast (2006) have taken on the issue of the link between economic development and institutional framework. They contrast two models of societies — natural state and open access — differentiated by the political pact established within the ruling elite and the economics that derive from them. Elaborating on this, we show that there is an intrinsic dynamic of constitutionalization processes by which citizens that might be granted unequal rights at a given historical step call for an extension and equalization of their rights, leading to the emergence of liberal orders characterized by strong equality in rights and, as a consequence, open competition both economic and political. The main driver of this evolution is the “call” of governed for adjusting existing constitutional arrangements, so that they can benefit from more capabilities and therefore more wealth and autonomy. The essential inhibitor is the will of elite to preserve the rents they get and share in a despotic regime that characterize natural states. There are however divergence of interests within national elites and among nations, which open spaces for agreements between rulers and governed, the former getting political support and increased revenues from tax thanks to the devolution of more rights to (some groups of) citizens. The development of the state as an efficient and impossible to fully control organization is a condition for the raise of an open access society. The state machinery appears as being the guarantor of open and fair competition thanks to the provision of neutral and efficient market and political infrastructures.*

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## 1. Introduction

What is special with the economics and the politics of developing countries? Why does the assumption always come to the fore that the interaction between these two spheres is often dysfunctional in these countries, that this is indeed a cause of the failure by many to actually converge with developed, western countries? Shall we satisfy ourselves with the answer that here is only a matter of time-lag in economic catch-up and institutional consolidation? Think just how old is Europe, and be patient! The proposition that some variables that drive development exhibit linear and parallel growth patterns, whatever the country, is century-old. Almost as enduring, however, is the alternate thesis that development is a plural, qualitatively diverse experience, not a Europe-led one. Typically, growth theory will rest on the first assumption, whereas specialists of social institutions and state building generally bend in the other direction. It should be no surprise that communication is often hard to establish.

Since the early 1990s' economists, mainstream or not, have however addressed the issue anew and have called for a more thorough approach of the role of institutions in market economies. Transition in Eastern Europe, or the experience of crisis and high growth in emerging economies have born here, at a time when new economic paradigms were coming to maturity: New Institutional Economics, Law and Economics, the Economics of Information and Incentives, New-Political Economy, etc. Although this literature has offered new theoretical insights and analytical tools to students of development, it still presents serious shortcomings as regard the questions being raised here. It remains difficult to account for the joint development of economies and state institutions, or of the state per se, as a specific political entity. Endogeneity has actually been considered by most as a problem to be solved: causality had to flow one way or another. This is most clearly the case in the series of papers initiated by La Porta et alli in 1998. Pinpointing the role of "legal origins" in the relative performance of national economies responded to an explicit quest for a structural feature, anchored in a most distant past, that would bear uniformly on growth, across countries and in all centuries. Legal origins, in other words, are no part of history or development, whether economic or else. It is a static, a-historical fixture. Critics may then only notice that today's gap between English and French GDP per capita, which may be the ultimate, implicit test in this approach, looks somewhat tiny as compared to the North-South divide. Though this line of research has opened new roads to academic research, its direct contribution to the understanding of development issue is probably not overwhelming.

Another research line has developed the concept of constitutional commitment. If a founding text had to be identified, in this field, it would probably be the interpretation of the Glorious Revolution proposed by North and Weingast in 1989. While drawing explicitly on the economic analysis of commitment and repudiation, they suggest that discrete turning points, made possible by unique, identifiable historical conjunctures, can actually shape institutions and political regimes for the long run. In this sense, their analytics are comparable to that developed by monetary economists when accounting for regime changes induced by central banks that commit themselves to a new anchor. The point is that there is no real on-going interaction, but only a founding event and derived adjustments by agents and related institutions. And beyond remains the broader question of why constitutional commitments do hold.

In a recent contribution, North, Wallis and Weingast (2006) have taken on again these issues and set them in a broader conceptual and historical framework. They contrast two models of societies, differentiated by their political institutions and the economics that derive from them. First are so-called limited access orders where only the elite accede most of the resources; revenue and wealth, protection and rights, markets and organizations. These insiders then

manipulate the economy in order to derive and allocate rents, so that all stakeholders or fractions have a joint interest in preserving the existing order. Limited access orders are then hugely unequal on most accounts, but they also provide a degree of stability, and allow specialization. In such context, institutional development may eventually occur and allow the emergence of an “open access order”, characterized by the opening to all of the capability to compete and create organizations, allowing specialization and empowering individuals. These societies are characterized by peaceful and generalized competition in all spheres: political and economical. Open competition delivers growth and adhesion, which guarantee self-enforcement of the order.

As will be clear in the following pages, this paper has a lot in common with the North, Wallis and Weingast one. We suggest, however, that the understanding of the relevant institutional strategies to promote development and growth request additional developments. First, we propose to deepen the understanding of the causal relationship between institutional and economic development. The process of development is linked to the ability to increase the social division of labor — and therefore to the extension to a wider population of an homogeneous economic order/market — and to the guaranteeing of the sustainability of competition — to allow innovation, the elimination of inefficiencies and the containing of rent capture — which calls for the emergence of what we qualify as liberal state. Beyond national specificities, states in open access societies guarantee equality in rights, and oversight the process of competition, and implement regulations aimed at providing market infrastructures (reducing transaction costs), and, finally, deliver “transactional services” aimed at guaranteeing security, protection against systemic risks and the liquidity of markets (which includes social regulations). We believe that the logic of provision of these different services should be endogeneized in the analysis of the “social contract” between the rulers and the governed. Second, we propose to analyze the dynamic of emergence and evolution of this pact between individuals and rulers. Beside the games played within the elite to guarantee the sustainability of a pact among the holders of the means to exercise and control violence, we believe that there is another game played between selfish and farsighted rulers and the governed. To save both parties costs and recourse to violence, there is a (*de facto* and sometime *de jure*) “social contract” by which the governed grant the rulers with rights to rule in exchange of the provision of services: ensuring security, guaranteeing rights, providing public goods. We see the process of evolution of this social contract as a process by which (some) governed call for more individual rights and more freedom of action (which induces open competition), which in certain circumstances can be granted to them by the rulers because it impacts positively on the economy and therefore on their strength and wealth. There is however an asymmetry between what the rulers gains in strength externally (against the other rulers) and the degree of their internal sovereignty, which decreases with the extension of the rights of governed. On this basis, we propose an agent-based approach of governance leading to sponsored orders and explaining the emergence (or not) of liberal states and justifying the intertwined logics of economic and political governance. We believe our dynamic theory of state linking (and endogeneizing) economic and political governance and enabling to identify the drivers and inhibitors of the emergence of liberal states is powerful to analyze various scenarii — from transition success stories to failed states — and that it therefore nicely complements North, Wallis, and Weingast’s analysis, since it allows to understand the possible processes of transition from natural state to open access society

The arrangements between the rulers and the governed are qualified as constitutions in our analysis. A given constitution — which is obviously a combination of formal and informal agreements among the members of the society, which compliance is ensured by collective beliefs, conventions and ad-hoc organizations — empower individuals by providing them

with capability to access, use and produce resources and with capability to self-organize. Economic and political rights are intricate since the later refer to the capability to voice, hence to balance the power of rulers and to participate to the decision in matter of public good provisions.

On the basis of this theory, we analyze the current situation in the developing nations. Several countries experience both growth and significant societal changes. Other seems to be trapped in inefficient joint equilibria. We question the sustainability of various paths of institutional change by pointing out the potential virtuous dynamics or the hindering factors, and the potential way to overcome them. Section 2 gets back to the analysis developed by North, Wallis and Weingast of the link between political institutions and economic development; that is the development of a socio-economic infrastructure enabling the accumulation of knowledge and facilitating collective action. Section 3 introduces our analytical framework by detailing how political pacts and economic rules of the games are jointly established, resulting in a co-evolution and the existence of drivers and inhibitors to institutional evolutions in both spheres. Section 4 highlights how these dynamics perform on the basis of two historical experiences: the development of Europe and the post-1989 experiences in “emergent countries”. Section 5 applies our framework to the analysis of the process of transition. We point out that various packages of rights, regulations and public goods, can be identified as the components of a liberal constitutional order guaranteeing open access. The combination of these packages and their sequence of adoption as part of the social/constitutional contract explain relative performances in the level and pace and development. We conclude by pointing out how the building of state goes hand in hand with the establishment of extended constitutional rights.

## **2. What are the drivers to open access societies**

### **2.1. Constitutions as pact within the elite**

The model proposed by North, Wallis and Weingast (2006) is clearly ambitious: all human history is encompassed, with dynamics elements accounting for the transition between successive stages in this broad account. Moreover, it is founded on a joint, economic and political approach that expressly rejects unilateral, causal relationships. And this mostly historical, backward looking paper is also cast as providing answers to why today’s developing countries do not fully converge with developed one, on both counts.

The main conceptual proposition put forwards here contrasts two models of societies, differentiated by the political institutions that govern them. First are so-called limited access orders characterized by one form or another of segmentation: only the elite have access to most of the resources — revenue and wealth, protection and rights, access to markets and to the organizations that support collective action. These insiders then manipulate the economy in order to derive and allocate rents between them, so that all stakeholders or fractions have joint interest in preserving the existing order. This is what brings them and glues them together: “rents therefore provide an incentive-compatible commitment device among the elites to maintain their coalition”. If this distributive pact is weakened or broken, civil war may erupt and the political order may just flounder. Violence is thus the ultimate, primary force that may destroy societies; and conversely, most of the time, their survival has lied exclusively on political repression by “specialist in violence” and rent-sharing pacts first between them, second between them and the other components of the elite needed to control the society, and third with the masses to limit recourse to violence and meet the “participation constraints” of most of the stakeholders. Corollaries to these rules are then neatly exposed: limited access orders are hugely unequal on most accounts, hence massively unfair, but they

provide a degree of stability, they allow some economic specialization and growth. Stability and civil peace allow institutions to develop on a limited scale, and in some circumstances they could constitute seed for the establishment of an “open access order”. Here the authors quote the rule of law or courts, which benefit first to the elite and then become accessible to the other groups.

Open access orders, by contrast, are historically rare experiments. The first in were England, the US, France and the Dutch republic, and the last ones to join the club may possibly be Korea and Taiwan. There may not be more than twenty or so countries of this type, today. Where the establishment of sources of rents was the key point, competition for contestable positions becomes the core of the socio-economic game. Although rent-seeking and competition are present in both social orders, the differences are the rules that govern them. Competition is restrained to the elite in a closed order society and it is largely a competition for positions with attached rents. These positions are largely granted on a personal ground, while they can be transmittable along lineage. Communities and social networks regulate this reserved competition. Open access societies rely on an opening of the competition to all, which means that all rent seeking positions are challengeable and therefore most of the time temporary. Open economic competition delivers growth and adhesion; a degree of self-enforcement will then unfold, as a great many will have a vested interest in defending property rights, the enforcement of contracts and the rule of law. This is indeed a qualitatively different game than the previous, where preserving and allocating rents did account for political stability.

The risk however of a drift back, from an open order to a more restricted one is always present. A key point to alleviate such brake-down is that political competition should be limited in scope: the constitution should withdraw a large part of the political and institutional system from the spoils of political contest (Przeworski, 1991). A winner-take-all game should never be allowed to re-emerge so that the losers of an election should keep guaranteed access to the competition and its organizational means. On this basis, organized and mobilized political participation, the threat of exit, and elections should make sure that a constitutional government, endowed with an effective monopoly over legitimate violence, will remain in place.

Yet, if backwards drift is always possible, the “holly grail” for social scientists, it is argued, is to identify what actually drives the transition out of a natural state into one that consistently defends open access. In this sense, North, Wallis and Weingast directly address the ultimate classical question of modern historiography and social sciences – i.e. the cause of the “European divergence”, and how other regions, or countries, may later adopt or adapt the institutions first established there, or alternatively fail or refuse to take that step. Since the days of Karl Marx and Max Weber, competing proposals never stopped being added to the list, and this contribution is put forward against this background.

How does the analytics of limited and open access orders help deliver a dynamic model? Here is the methodology: “To explain how the dominant coalition expands access, we must identify how the natural state’s self-limiting forces are overcome”; and this “requires explaining how small increases in access in a natural state can somehow grow into a full blown transition” (p. 49 and 50). And, “for insights into those processes, we must look to the interaction of institutions and organizations” (p.48), the latter being the vehicle of collective action, civic or economic.

Now, the theoretical machinery that accounts for transition is more intricate. First, institutions supporting impersonal exchange should emerge. Typically part of the elites of the incumbent natural state progressively shed personal, hierarchical links of allegiance and patronage. This

brings society on a so-called “doorstep”, meaning that it is on the threshold of switch, though without it being guaranteed – Athens, Rome or medieval Italian republics reached that point but did not brake through, we are told. Three conditions should actually be respected for this, that are again all closely linked to the broadening of impersonal exchange: the extension of the rule of law among the elites, the emergence of perpetual forms of organizations, and political control over the military (as a derivation of rule of law). The authors mention for instance the development of courts that defend property rights and contract enforcement; or access by an ever larger share of the elites to the capability to settle organizations, like corporations, that becomes permanent (just as the state has).

The core point is that the benefits of extended impersonal exchange should make the whole process self-supportive, as the benefits of specialization and growth feed back: “we call the ways by which large numbers of elites benefit from widening access transition mechanisms. Transition mechanisms are the elements of social arrangements that can potentially make most elites better off as access opens, thus blunting the threat of reorganizing the dominant coalition” (p. 64). The whole process may then be further reinforced by the development of regulatory policies to allow redistributions of rents, of representative institutions, of agreements among states to allow international exchange and police international competition, and the support of inherited institutions that may become functional in the new order (elections are mentioned).

We are clearly admirers of the model put forward by North, Wallis and Weingast. It is elegant, parsimonic, and powerful. It draws directly or indirectly on a wide library of classics, ranging from economics and economic history to political science and political philosophy. It is also a versatile model that can shift from large social orders, like a society and its complete state machinery, down to communal, civic or even religious groupings. Topics like social asymmetry and coercion, economic interests and political action, or constitutionalization and competition are nicely brought in as the reader proceeds through the paper. Last but not least the whole framework indeed helps understanding how economic and political factors may interact dynamically in the course of historical processes.

In the same time, we think the analysis can be deepened to get a better understanding of the potential factors blocking the switch from a natural state to an open access society. We indeed believe that the limit of the proposed framework is that it lacks an analysis of the alternative dynamics of the various paths of evolution between the two types of societies. Section 2.2 discusses the micro-foundations of our model of collective choice in matter of governance, and section 2.3 the theory of state and state development that is being proposed.

## **2.2. Constitutions as the glue between all stakeholders in a society**

North, Wallis and Weingast’s model is an agent-based model where interests, cooperation and exchange drive social outcomes. More precisely, it is an “elite-only” model: both the internal dynamic of limited access orders and the transition to open access are driven exclusively by competing fractions that trade off violent conflict and rent-seeking arrangements. It then happens that a rare constellation of interests may sometimes allow for a (quasi)Pareto-improving shift towards more competition, hence more revenue or rent to share. This structure in turn derives from the initial theoretical premise that political orders are built to contain violence: natural states are built by coalitions of “specialists of violence” that impose social peace against a fiscal tribute. States, hence, are founded on a very raw, non-socialized, direct notion of power.

Though we are not interested per se in discussing what the initial stage of social life looked like, these propositions have two consequences that come at a cost. First, order or stability

being founded on domination and coercion, there is no way “the masses” would have a meaningful role; at best they may ultimately join the elite and share their privileges, as their political franchise will thankfully increase. While the dynamics of conflict is being played out among elite groups, the true social violence is thus exercised against this vast majority that produce the revenue, which the elite jointly appropriates. Just as in Marxist historiography, exploitation is thus maximal and legitimacy an illusion, one would think; the only difference is that the dominated class has no say in the future.

Then is a difficulty to address the internal diversity of the elites. As stated, they are first defined as professionals of violence, though latter they also include ecclesiastics, teachers, traders and others. In a natural state however all the latter are supposed to keep a privileged relationship with a given fraction of the violent ones, in case civil war would erupt. The logic of establishment and evolutions of these protective contracts is however not really developed, which translate into a silence on the way various groups are included in the elite (and constructed), and how they get credible guarantees to avoid capture by the specialist of violence. It then prevent to explain how these groups get emancipated from this link of dependence, which lead to the situations in which the monopoly over legitimate violence is in the hand of the sole state and the military under civil control. We think it is useful to develop a bit further the political sociology of the relationship of each of the elites fractions among them and with the becoming impersonal organization that the state is. In medieval Europe, universities, trading communities or franchised cities were generally established at a distance from the latter, which suggests a degree of autonomy, hence a variety of possible political dynamics and outcomes. The interests of the 18th century English manufacturers, or of the French intellectuals, were not necessarily always aligned with those in charge of public affairs. Earlier, the interests of Northern Italian trading cities were neither completely aligned with those of the Papacy, or the Holy Roman-German Empire. Yet, these actors were sociologically part of the *élite*. Or were they all united by the fear of the mob?

Brought together, these two patterns — no role for the masses and homogenous elites — make it difficult to generate alternate scenarios of political change. Gradual, dynamic, Pareto-improving changes are probably the sole model of change that can be formalized on such basis. With mostly homogenous agents, only few alternative systems (equilibria) or few dynamics of evolutions can be envisaged. Moreover, the alignment of interests both within the elite and among the masses does not really allow to endogeneize changes. At least, processes of evolutions seem to be non-intentional: conditions just emerge where agents of the elite rise to the opportunity.

Also, the understanding of societies as principally shaped by a “contract” among the elites, leads to the idea that change may only comes from the core of the political system. Hence our question: what about political and social changes that emerge from the fringes — whether the masses, or aggrieved segments of the elites, or an alliance of the two? The US, French and Japanese Meiji revolutions all had their origins in such conjuncture, and they all became open access societies. Or think to Poland in 1981 and 1989. In other words, drivers of changes and non-linearities in historical processes are a problem when starting from the present micro-foundations.

### **2.3. The state as the provider of public goods deriving and credibilizing the social contract**

Let’s recapitulate. The natural state is exclusively about extracting rent and exercising coercion. This activity shapes the whole social order as the elite directly manipulates the economy. In an open access model it is of second order. The state should first of all defend property and contractual rights, defend the contestability of markets, and rent distribution

should just aim at alleviating conflicts that may eventually threaten its core constitutional mandate.

While this vision of the state is fully consistent with the theory proposed by North, Wallis and Weingast, we think it leads to ignore a central function of state in modern societies: the provision of “public” goods aimed at materializing and credibilizing the social contracts among the diverse stakeholders in the society. Present day states in open access societies offer widely different packages of public goods and services and, over time, in each of these countries, this package has varied a lot. These variations affect property rights and the freedom of contracting. How to account for this diversity? Should a larger supply of public good only be interpreted as a higher gradient of rent-distribution, hence as the sign of a degree in the open access character of the society? Or do these differences lie in the differences in the perception by the citizens of what is the legitimate mandate of their government in line with the collective preferences voiced thanks to the open access character of their polity?

We do not suggest that this model, or any competitor, should actually absorb all the diversity of historical experiences. We already applauded its sobriety and elegance. The point is whether the theory of open access states provides an analytical framework to analyze the specificity of the Swedish path of development and to compare it to the US one, and to compare these two countries with other members of the open access clubs, to be able then to compare paths of evolutions as different as Brazil, India, China, Russia and so on, and so forth.

We believe the rent-centered approach to state building, does not fully allow understanding the process of construction and legitimation of the state in modern societies. The authors frame limited access orders exclusively on the proposition that the elite extract and share rent, and that this activity actually shape society. Exiting this social model then calls for the abolishment of barriers to competition and entrepreneurship. We agree that insecurity of persons and rights was endemic, and that coercion and rent-seeking were defining elements in the political economy of pre-modern societies. But this is different from framing them as implicitly market-oriented, free-wheeling, individualistic orders which potential for emancipation and entrepreneurship was abjectly thwarted by professionals of violence. Obstacles to the emergence of competitive market societies were not essentially political, in the sense that they derived from a command-and-control structure. They stemmed from more horizontal constraints, that is from how local communities were organized and how they very clearly limited the potential for commercial or monetized exchange between their members. Conversely, opening to trade the mass of these local communities that made the social tissue of pre-modern Europe was not primarily about relieving them of artificial, overbearing institutions. It was about breaking up these communal orders and the whole body of norms and mostly informal regulations, so as to let market forces in. What modern and early-modern states were mostly about, between the 16th and the 19th centuries, was not only about the abolishment of a past, low-potential order, but also about the construction of integrated market economies and polities.

Let's put this in different terms. Competition and contestability, whether in the economic or political spheres, are primarily a matter of equalized and individualized rights (which is different from personal rights). Limited access societies were not merely characterized by the absence of rights (that is, by outright extortion and coercion), but by rights endowments that were arguably weak but mostly as well collective, unequal and hugely fragmented across territories. In other words, my rights derived from those of the community I belonged to, and they were very different from that of my neighbor. If I left my community, or was excluded, then not many remained with me. And if I wanted to compete at the local market or enter a new business line, access was not necessarily even. This is where impersonal exchange comes



in. Impersonal exchange requests that your (property, contractual, etc.) rights are general, abstract, and opposable to any third party. This is because compliance is ultimately ensured by a distant, powerful and recognized authority — the state — not by local orders or reputation-based networks. Open access order and impersonal exchange are one and the same thing.

This has two major consequences, which we shall now elaborate. First the interaction between individual agents and the state should be much more central when explaining transition to open access orders. Second, that transition is much more complex and conflictual than assumed, which is a reason why it is so difficult, why it often fails, and why the early-modern European experience does shed light on the difficulties encountered by Developing countries when trying to enforce this unique rules of interaction between profit-maximizing individuals and a modern, most-powerful, though constitutionalized state. Indeed, the process of emergence of an open access society is not only a question of bargaining between the elites and the other stakeholders in the society. It is a process by which an independent and anonymous arbitrator — the state — emerges. Its role is to guarantee the social contract among the various stakeholders, in particular by providing various types of public goods that are necessary to the efficient performing of a market economy; which comprises the provision of market infrastructure to decrease transaction costs, of means to socialize risks that may hinder entrepreneurship, and of policies aimed at facilitating the performance of systems in which the combination of strong interdependencies and decentralized decision can lead to instability and inefficiencies (e.g. in case of externalities).

### **3. An analytical model: towards a better understanding of Constitutionalization and the provision of collective order**

#### **3.1. Delegation at the roots of Order-Providing Entities**

To better understand the economics and politics of transition to an open access society, we propose an analytical framework aimed at first, clarifying concepts within and across disciplines, second, establishing analytical categories to understand the role of state in modern societies. In particular, we contrast the various entities interacting in the provision of an order, and we analyze the possible combinations among these entities.

This framework is based on an individual-centric approach. We contrast various models depending on the nature of the delegation granted by individuals/economic agents to the entities providing order. It must be clear, however, that this is a pure analytical perspective. We are not claiming that from an historic point of view, these entities emerge from the delegation by human beings constituted as free individuals from the beginning of human history. We will return to this issue in Section 3.

To establish our analytical categories, we start with individuals recognizing their collective coordination needs and who, therefore, decide to delegate rights to establish collective order to entities.<sup>1</sup> These entities can be individuals — as a sovereign — or groups; the latter being spontaneously established (i.e. a community) or formally settled (i.e. an organization). What matters is that individual agents grant this entity with rights to establish an order. An order

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<sup>1</sup> Delegation can be explicit or implicit. It is out of the scope of this paper to discuss the various ways individual actually delegate the provision of collective order to alternative entities. We acknowledge that in actual fact individuals are born in established orders. They then decide to opt-out or not. They can also adhere to other complementary or substitute orders. And finally they can create new orders. Moreover, these orders can be formal or informal. A formal order is based on an identified principal to whom authority is (explicitly or implicitly) delegated. An informal order is based on the convergence of individual expectations (Aoki, 2001; Dixit, 2004). In this paper we focus on formal orders. However, even when it is a question of informal order, delegation (to the “community” characterized by its beliefs, values, customs, etc) occurs in that individuals might always opt out. If they do not, they adhere and therefore accept to waive their individual sovereignty in certain domains to benefit from collective services.

results from the settlement of rules, i.e. rights to take action and access or use resources, and from enforcement to guarantee compliance. In an economic perspective, both activities consume resources and a cost-benefit analysis can be applied to alternative ways of producing an order (Barzel, 1989; North, 1990; Williamson 1996). On the one hand there are costs linked to the fact that individuals waive part of their sovereignty. By agreeing on limiting ex post their freedom of action, they might lose opportunities to adopt first-best behavior in some circumstances. They might also be forced to contribute to the production of collective services. Lastly, there is a risk of capture of rents by the order provider. These costs and relational hazards are compared with the benefits. Fundamentally, an individual benefits from collective services that are either less costly than if he had to produce them alone (or by contracting on a purely inter-individual basis with the other agents), or that would simply not be provided because “externalities” would prevent their production at an “efficient” level<sup>2</sup>.

Choices in matter of governance involve selecting various types of coordination or collective action problems and deciding how they should be addressed. One element of choice is certainly the size of the community that complies with a common order and this leads to the choice of a more local vs. global level of provision of an order. We discuss this issue in greater depth in a joint paper. Another element of choice is the type of delegation. We think it useful to contrast two types of delegations that are the *extrema* of a continuum from weak to strong delegation. This continuum goes hand in hand with the extension of the number of domains to which a right to regulate is delegated to the order provider and with the extension of his authority (i.e. the extent to which he can impose constraints on the individuals). So “strong” delegation means extended authority provided to an entity on a wide set of domains. It establishes extended rights to design rules, and to use all sorts of means, including violence, to ensure enforcement. “Weak” delegation means bounded authority on a limited set of domains. It relies on restricted rights to regulate and to enforce, and often on the granting of these rights to different entities.

Whether a question of weak or strong delegation, individuals might delegate authority to an entity for two reasons. First, they need resources to facilitate bilateral exchanges (in the spirit of New-Institutional Economics; cf. Greif, Weingast, North). Second, they need to solve collective action problems in the provision of public goods (in the logic of fiscal federalism and public choice, and also in line with political science). These two issues are closely related since the resources that facilitate bilateral deals and trade are, to a great extent, public goods, whether a common language, a monetary system, mechanisms to guarantee security of exchanges and avoid fraud, etc. Collective regulations, whatever they are, lead to the recognition of rights that are opposable among individuals. These individual rights form the basis of human autonomy and individual action. We believe they are closely linked in two domains: economics and politics. Indeed, individuals are interested by their individual wealth, hence by their ability to allocate resources and accumulate them. They are therefore motivated by the establishment of property rights systems and by infrastructure facilitating trade. At the same time, they have both an indirect and a direct interest in their ability to influence collective choices. Since part of their economic wealth depends on resources that are provided at a collective level, they positively value the ability to influence collective decision making on the matter. More generally, individuals are members of all kind of communities within

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<sup>2</sup> Externalities occur when an individual does not take into consideration the impact of its individual decisions on utility of other agents. It draws from technical/natural interdependence and from social arrangements (that establishes or not means to “internalize” externalities. When externalities are not taken into consideration, there is a sub-provision of the considered good or service since those who decide to produce do not consider the benefits drawn by others. Also the good can be over-consumed, meaning that those who can consume it do not consider alternative use of the good that could result in higher social benefits. What is usually called “public good” — a good that consumption is not rival and from which it is impossible to exclude any stakeholder— correspond to an extreme form of externality. Free access to these goods allows consumers to benefit from it without considering its costs of production, which deter potential provider to produce this good.

which solidarities pre-exist. They value the ability to influence collective decisions, to exercise reciprocity toward the community, to be recognized as a member, etc. They therefore simultaneously call for the recognition of economic and political rights: rights to trade and rights to voice.

Below, we explain why different types of delegation result in differences in the ability and “legitimacy” of various types of authorities to establish a collective order (Section 2.2). The choice between a “strong” and a “weak” delegation results in a trade-off between costs (in terms of sovereignty) and benefits (in terms of strength of rights). “Strong” delegations are granted because individuals want to benefit from well established rights when it comes to issues they consider more important than others (from rights to live, to clean air, and including rights to being literate, to benefit from economic security, in the Western socio-democrat societies of the early 21<sup>st</sup> century). However, the entities benefiting from such delegations have strong incentives to capture wealth from the stakeholders. “Strong” delegations are therefore granted in exchange for significant guarantees. What we qualify as “constitutional” guarantees provide the public regulator with the “legitimacy” to rule, with an ability to define the “collective” interest and to arbitrate between private interests (Section 3.3). Public regulators are however granted different levels of recognized legitimacy (and resulting authority) depending on the type of guarantees provided to the individuals-principals by the constitutional delegation (Section 3.4). We therefore compare different types of constitutions and, in particular, despotic vs. liberal ones. The former guarantee less equality in rights among citizens than the latter.

### **3.2. “Constitutional” vs. “Bounded” delegation and the difference between “public” and “private” rulers**

Beyond the strong/weak delegation difference, there is a difference (and a continuum) between what lies at the origin of public or private ordering. A public order setter benefits from a strong delegation by the citizens who delegate him with the task of establishing their fundamental rights. We recognize, of course, that this analytical vision does not correspond to the historic emergence of this delegation, as will be highlighted in section 4 later in this paper. It is, however, important to consider how the notion of public ordering and its legitimacy draws on the (sometimes implicit) recognition by the citizens of such a “strong” delegation (which might also explain the self-legitimatization of rebellions and secessions when the legitimacy of the public order is no longer recognized). It is also vital to recognize that the definition of fundamental rights is subjective and that individuals can decide to extend it quite widely (as discussed later on). At this point it is sufficient to point out that these “fundamental” rights are both economic and political. They establish the degree of autonomy of citizens/economic agents and therefore their capability to trade, self-organize, and voice opinions when collective decision-making occurs.

For an individual (who is a “principal” in the agency theory spirit), a strong delegation (to an “agent”-ruler) is more risky and costly than a weak delegation, since the agent to which authority is delegated benefits from powerful authority that can be relied on to capture rents, extort wealth and even cancel any further possibilities of negotiation and exit by the principal. Therefore a strong delegation is granted only when safeguards can be implemented (unless *ex-ante* the principal who delegates has no negotiating powers with the agent). These relational hazards are *de facto* controlled by the bounded aspect of a weak delegation. The regulator-agent can damage the individual-principal only marginally (since he has authority for a limited domain only) and the latter always has the option of breaching the agreement since he did not really waive his freedom of choice.

The determinants of the choice between a strong or weak delegation to a third party are

twofold. First, it depends on the strength required — in terms of renegotiability and compliance — of the rights and rules established through this process of delegation. Any collective order results in rights (to do, to access, to benefit from) that are opposable to others. Individuals recognize that the production of individual rights — opposable to third parties — is partly a problem of collective action because these rights have to be mutually recognized and must be established against others (which makes it worth benefitting from economies of scale and scope and from learning effects linked to mutualization by and delegation to a specialized entity). Recognizing the rights to command — which is authority — of an entity that will benefit from same recognition by other individuals, will allow this entity to become a mutual guarantor among those who accept to subordinate to it. In addition, this entity becomes an aggregator of individual coercion means, which constrains those who do not delegate any authority to this entity to recognize the rights of those who do delegate. A strong delegation is therefore more likely to be needed and accepted to establish and defend the rights individuals consider the most important (whatever they are).

Second, if we assume no asymmetry in terms of negotiation capability *ex-ante*<sup>3</sup>, granting a strong delegation also depends on the ability to implement safeguards in the “contract” between the individual-principal and the order provider-agent. One solution is to avoid relying on one agent only. Indeed dividing the delegation of authority among a set of agents limits the authority of each one (and therefore each agent’s capability to capture) and implements competition among them (which reduces the need to oversee their activity — since they mutually control each other — and provides them with incentives to perform efficiently). De-multiplying the number of agents presents, however, one drawback. It increases transaction costs (and raises the number of bilateral relationships affected by information asymmetries). Moreover, the positive impact of this division of delegation is effective if collusion among the agents to which authority is delegated can be prevented. Thus individuals will tend to accept to provide a third party with strong authority to regulate only if they can divide authority at a low cost and prevent collusion. A good way is therefore to delegate authority to an organization where “checks and balances” are organized among individuals whose positions can be challenged so as to weaken their capability to endlessly capture rents and progressively void any negotiation capability of the principals. Also, the ability of principals to permanently question the delegation granted to the agent leads the latter taking into account the will and the interest of the principals

Thus when “fundamental” opposable rights must be established, individuals might accept to grant “strong” delegation to a regulator. Such a delegation is more likely to be given if a solution à la Montesquieu of division of authority can be implemented. It indeed ensures efficiency while controlling abuse of dominant positions. Individual rights are established (and further redesigned) by a legislative system aimed at guaranteeing the interests of the stakeholders are taken fairly into account. A judiciary is responsible for guaranteeing enforcement. The executive branch resolve the collective action dilemma over the provision of the necessary means to have the legislative system and the judiciary actually operating, to guarantee the defense of citizens rights to any third party or coalition, to provide the collective services that result from the definition of opposable rights. An important aspect of this division of power “à la Montesquieu” is that the creation of a judiciary to solve disputes between/among rights holders includes settling conflicts between the principals (citizens) and their agents constituting the ruling entity. That is an important guarantee for the delegating

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<sup>3</sup> Because we do not assume a (theoretical) world in which the principals have no margin of maneuver in front of the agent to which they decide to delegate some part of their freedom to decide. Indeed, this situation is of no interest from an analytical point of view since in that case of absolute power, there is no delegation possible. In the same time, it is not incompatible with our framework, since it can be considered as an extreme case of “negotiation”. Of course, we recognize that this extreme case occurs from time to time in history (and is at the origin of various forms of slavery).

principals.

When the strength of opposable rights is less an issue<sup>4</sup>, the delegation of authority can be “bounded” according to two interpretations. First, only a reduced number of narrow domains of authority are delegated to the regulator. Second, only partial rights are delegated; for instance, the right to settle conflict but to redesign rights. The combination of the two results in the design of a delegation scheme that provides fewer safeguards than in the case of constitutional delegation. Safeguards come from the narrow scope of the delegation by itself. They result, however, in lower capability and legitimacy to implement individual rights and collective rules, since some entities can be provided with the right to design rules without checks by all the stakeholders, since conflict settlement procedures can be established without any system of appeal or strong guarantee of independence, since executive capabilities can be deprived of significant oversight and sanction capabilities, etc.

To sum-up, strong delegation, at the origins of public ordering, is characterized by a wide scope and high enforcement capability and strong guarantees at the origin of legitimacy. Conversely, weak delegation, at the roots of private ordering, is characterized by narrow scope and limited enforcement capability. The request for guarantee is therefore lower and potential competition among rulers tends to prevent capture and encourage the efficient provision of collective services. We point out, however, in Section 3.4, that different types of constitutional delegation might exist and result in more or less sharp contrasts between private and public regulations.

### **3.3. Legitimacy of Public Regulators in the building of collective interest**

Before comparing several types of strong delegation, below we explain why a constitutional delegation opens the realm of alliance where solidarity is established among individuals with conflicting interests, whereas a bounded regulation opens the realm of contracts where individuals manage their converging interests of being provided with a common service.<sup>5</sup>

Constitutional delegation grants the regulator the legitimacy to “build” the collective interest. Two reasons explain this. First, since the logic of a constitutional delegation is to establish individual “fundamental” rights, principals have incentives to jointly delegate to a common public regulator with those with whom they may have conflicting claims (over these fundamental “rights”). Indeed, if there is no interaction among individuals, establishing a common order is useless. On the other hand, the more conflict over claims on the more essential rights, the greater the need for an agreement on a common order. Thus a public regulator will have to reconcile conflicting interests. In addition, he has to solve the collective action problem of mobilizing resources to defend the fundamental rights of his principals against any claim coming from outsiders. One of the reasons for this is to maintain the cohesion of the principals around the joint constitutional delegation. Thus the public regulator

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<sup>4</sup> A typical situation in which the strength of rights is less an issue is the case of “club goods”. Since, by definition, access/exclusion to/from a club good can be controlled, there is no negative externality between those who contribute and those who do not contribute. The (efficient) provision per se being in the interest of the members of the club, individuals have spontaneously interest in contributing and in complying with the common constraints.

<sup>5</sup> It is worth pointing out that the opposition between the logic of alliance (behind strong delegation processes) and the logic of contract (behind weak delegation) meets general categories traditionally recognized in social sciences as contrasted drivers of socialization. On the one hand, the logic of alliance stems from the temporarily suspension of confrontation between diverging interests to fight a common enemy. This is an exclusive process (people are *either* friends or foes) ruled by distributive rules to ensure cohesion. In such a setting, politics come first in the sense that external constraints create solidarities and allow allies to jointly build and exploit common resources. This, in turn, opens new avenues for trade and joint ventures. Such a process of building common governance resources has to be contrasted with the logic of contracting that rely on the convergence of interest among individuals that seek to optimally solve common problems. This logic is inclusive in the sense that every actor is a potential partner for every other. In such a setting, bilateral contracting can lead to the building of collective regulations, because the necessity to warrant contribution to public goods (starting by the security of inter-individual exchange) leads actors to build adequate institutions to accommodate their collaborative spirit. Historically, as it will be illustrated in section 3, these two basic processes of alliance and contract combined to result in the present division of tasks among public and private regulators

has to take into account the interests of all the stakeholders and guarantee each of them a “fair” return on his strong delegation. Otherwise, the individual will leave the coalition or break the order (if it is too costly to leave). The public regulator is therefore mandated to provide collective services that ensure an acceptable benefit/cost ratio to each of its principals (the citizens). Since individual preferences are non-aggregative — because the loss of (subjective) utility by an individual cannot be compensated by the gain in utility of another individual — the only solution is to have the ruler decide the nature and level of the provision of public goods. While we know there is no right solution for revealing the genuine needs of individuals in terms of public goods, and no way to make decisions that will meet with all the stakeholders first-best, the only solution is to rely on a “benevolent dictator” (à la Arrow) that defines the collective interests under the constraint of maintaining cohesion. Second, it is important to point out that in dynamics, a logic of extension of fundamental rights takes place. Indeed, individuals have endless needs and any public regulator is likely to increase the level of the provision of rights and associated services to reinforce the justification for a strong delegation of authority in its favor (more on this in the next section). Both result in the recognition of the legitimacy of the public regulator to define what the public interest is. This legitimacy is based on the fact that when constitutional safeguards are well designed, each “citizen” rationally admits that the individual constraints he faces are established in the “collective” interest and they are one of the beneficiaries (while, of course, each individual citizen, at the same time, tries to lighten the burden of the constraints he has to face).

There is no such logic in the delegation between individuals and a private regulator. Indeed, the weak delegation is really a targeted one in that the regulator does not have to take care of the interests of its principals beyond the narrow purposes for which delegation is granted. While those individuals in charge of a private authority might be keen to extend the scope of their delegation to benefit from a more favorable balance of power vis-à-vis their principals (which would become more dependent on the collective service provided by the authority), the loop that we described as taking place in the case of public authority is less likely to initiate. Indeed principals ex-ante decided that they should not waive too much freedom to act and take decisions because the services they gain from the private regulator are not essential. If they were seeking more collective services they would delegate to additional authorities, rather than delegating several services to one authority<sup>6</sup>. Second, what leads individuals to agree on a common authority to which only a bounded delegation is granted is their converging interest on the matter. They do not meet because they have conflicting claims that must be conciliated and guaranteed. They meet because on their issue in common, they have converging interests. In other words they are in a coordination game rather than a prisoner’s dilemma.

All this does not mean, of course, that the individuals behind a private institution do not have diverging interests. Of course they have. But they agree on creating a common order on issues where they do not have diverging interests. Consequently the entity to which the responsibility for providing an order is delegated is responsible for providing a regulation service that serves the interests of its principals in the specific domain. Enlarging the scope of its contribution leads to domains where interests are likely to become more divergent. Thus, everything equal, a private regulator is only likely to consider the interests of a reduced set of principals and only has few possibilities for extending the scope of his intervention.

### **3.4. Despotic vs. Liberal Constitutionalization**

In this section we compare two alternative types of constitutions that differ in terms of the

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<sup>6</sup> More precisely, they will compare the higher transaction costs of dealing with several authorities for various purpose with the cost of higher risk of capture by an authority providing several services (since costs of switching to an alternative authority increase).

level of equality in fundamental rights guaranteed to the various adherents to an order. In what we qualify as the “despotic model”<sup>7</sup>, there is unequal distribution of rights ex ante among the principals. On the other hand, a “liberal” constitution is characterized by equality in rights among all “citizens”. Beyond is the contrast between the extent of the delegation of authority conceded to the ruler and, on the other hand, the guarantees he provides to citizens with regards their fundamental rights, both civic and economic. This difference then has a strong impact on the evolution of the constitutional contract and the relationship between public and private ordering. It also impacts upon the openness of competition within the society; on the rule of law; and on the political regime, as explained below.

Up to this point, for the sake of clarity we sharply contrasted the logics of public and private orderings. And in so doing we may have suggested that our general categories were in fact Euro-centric and time-bound: our language draws from the contractual theory of the State, which has shaped modern, liberal political philosophy according to John Locke, to cite but a single example. The opposition between a despotic and liberal regime now helps provide a more differentiated approach to the private/public interaction, albeit one that is still based on the same basic, analytical language. Explicitly historical considerations will come up in the next section.

Let’s start by studying the emergence of collective governance as proposed by Brousseau and Raynaud (2008). They basically assume that agents are ex ante heterogeneous: they have different endowments, preferences and localization in the networks structuring societies. Hence norm setters or institutional entrepreneurs compete when common orders are being designed and adopted, in order to coordinate agents or support collective action: they promote alternative solutions for a given coordination problem in a given community (supporting for instance market exchange or the production of public goods). The resulting order reflects therefore primarily the preferences and needs of the winning party. Though all agents should expect to benefit from reduced transaction costs, the needs of core members at the center of groups designing and implementing the collective governance solutions will be better addressed than those of fringe agents. Indeed the latter will incur higher coordination costs of than their first best (see Section 4).

In other words, collective orders are essentially asymmetric. They are made up of various “circles” that offer uneven benefits to individuals. In the case of public orders, however, large delegation contracts imply a greater coercion capacity is given to the rulers, hence marginal agents incur more risks. Though they may represent the vast majority of the population, they may be exposed to various forms of discrimination, as regards taxation, market access, public infrastructure, spillover growth, protection of property rights, physical security, etc. The informal sector on the margins of large conurbations in present-day developing countries is a good case in point.

Asymmetry of course raises the problem of constitutional design. Modern, democratic or liberal constitutions are indeed based on the principle of equality of rights among citizens, whatever their social, geographical, professional, ethnic or religious origin. The founding writers of modern constitutions explicitly assumed that public institutions at least should not contribute to the many asymmetries already present in society. Equal opportunities should be

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<sup>7</sup> The notion of a “despotic regime” is altogether dated, rarely in use, and possibly euro-centric : starting with Montesquieu, despots have often been implicitly or explicitly oriental, non-christian, and essentially arbitrary. They would not be ruled by *any* constitution and may just be a typical orientalist fantasy. In this paper “despotic” is defined primarily as the opposite to liberal, in both the economic and political dimensions; and, as stated, “liberal” is primarily defined in terms of equality in individual rights, hence in terms of autonomy of the citizen-trader vis-à-vis the sovereign and, as a consequence, in terms of contestability of political and economic markets. We also remember the tradition of the *Despotisme éclairé*, which is not identical to the specific case of the Weberian “sultanate regime”. Others could certainly have preferred a different antonym: authoritarian, unequal, aristocratic, corporatist, status-based, or even illiberal. To our understanding, “despotic” is however better because it is more comprehensive: it includes the economic and political dimensions, it can qualify antique and contemporary experiences, Western and non-Western ones – or so we assume.

offered to all, so as to satisfy ethical concerns and foster unity of the nation.

We thus assume there are two generic models of constitutional delegation: liberal and despotic. Liberal constitutions are based on a principle of equality of rights, whereas in a despotic one their unequal distribution among the principals is explicit: inequality is embedded in the structure of delegation contracts, hence in the ex ante cost/ benefit trade-offs of the respective social classes, casts or status-groups. Some principals have more rights than fringe members and their rights are greater than those of sidelined citizens who benefit from less constitutional guarantees. Such a constitutional contrast has major consequences, especially with regards the patterns of a dynamic equilibrium.

First, equal rights under a liberal constitution imply that the political market is more open and hence contestable. This plurality of social or private interests makes it essential to design collective decision mechanisms, whether they address the definition of rights, the design of market infrastructures or more generally the provision of public goods. Because unanimity is out of reach due to negotiation costs and delays, linking majority rule with freedom of expression is vital. As they accommodate new rights, rulers then take into account a larger spectrum of interests and demands; alternatively, new public goods are more equally shared — a situation that favors the formation of a majority coalition supporting the extension of individual rights, if not consensus<sup>8</sup>. Hence the dynamic pattern embedded in this constitution: the scope of the common interest may be steadily extended over a prolonged period of time, typically from the security of individuals and property rights to, say, rights to health insurance coverage, old-age support, basic or extended education, counter-cyclical macroeconomic policy, etc. Hence the possibility of a long-term dynamic of political development: as the demands from a larger share of the population are better addressed, and as the benefits of scale, scope and specialization are better exploited on the supply side, the state benefits from increasing legitimacy and fiscal resources. Think to the New Deal era in the United States, or to post-World War II Western Europe. In turn, governing elites increase their ability to capture rents as, more generally, the private benefits of being the recipients of high-powered delegations.

Conversely, in a despotic world, the contract between rulers and principals is narrower and much less dynamic. Endogenous change, whether political or economic, will be much slower. Because a large part of the population does not benefit from rights and because access to voice is limited, the common interest is more reduced: it is typically limited to security for all, plus a reduced package of services for the happy few, such as round-the-year entertainment in royal palaces like Versailles. As the supply of public goods and services is reduced, the “legitimacy loop” observed in the previous case does not work and the pool of resources from which the State can draw is also much smaller.

This highlights a second difference between the two constitutional models. Because fringe subjects under a Despotic government have low trust in their rulers and low guarantees against extortion, they try to limit delegations and divide them among different suppliers of public goods. They will typically rely on local solidarities — i.e. family, lineage, ethnicity, guilds or municipal communities — to ensure their provision, rather than entrusting supplies to a single, distant, uncontrollable and rent-seeking state. The contrast between public and private ordering is therefore blurred: most public goods will be provided by local fragmented orders that may provide both private and public goods, though with little benefits in terms of size, scope and specialization. In other words, the dynamics of political development will remain weak though the underlying constitutional order may be quite stable. Individuals will

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<sup>8</sup> The only limit to the extension of fundamental rights is the cost of producing them — or more precisely the costs of the mechanisms that turn them in actual rights — that can be superior to the willingness to contribute of part of the population.



be stuck in their traditional solidarities that may protect them against the despot; and in turn, the state will be prevented by its weak legitimacy from extending beyond the “minimal”, initial contract<sup>9</sup>.

Symmetrically, in a Liberal order, equality of rights within the polity, the benefits of centralization and the underlying growth dynamic in the provision of public goods are powerful forces against locally contracted orders. Equality among citizens deprives communities from the legitimacy of placing local orders beyond the provision of public goods with closed “clubs”. It de facto reduces their capacity to manage solidarity on an inter-individual and voluntary basis, since any effort to coalesce locally might be considered an attempt to escape national solidarity, to weaken equality among citizens and possibly to capture rents. The state therefore becomes the ultimate legitimate manager of solidarities, the architect and arbiter of their division of labor, as well as the ultimate guarantor of equality among citizens. Centralization is thus a core component in the establishment of a liberal order, first and foremost because self-standing, self-enforced local orders are being steadily weakened or marginalized. At equilibrium, however, the provision of public goods in a Liberal constitution might not necessarily be more centralized than in a Despotic one. What is thoroughly centralized under *any* Liberal constitution is the overall hierarchy of norms and laws: local orders have to be confirmed by superior ones, conflicts of jurisdictions are adjudicated from a superior level and, critically, the fundamental rights of citizens are established and defended at the highest level of political organization – say, the national constitution and the Supreme Court. Private conflicts are then submitted for arbitration to the state and *social norms* enunciated by *private actors/players* are changed into *bounding rules* enforced by *public institutions*. This is why the centrality of law — the rule of law — is characteristic of Liberal constitutions: interactions between more autonomous agents, as well as between public bodies, are increasingly governed by legal or rule-based principles — contracts and private law in the former case, administrative/ constitutional law in the latter. Conversely, a (traditional) Despotic constitution would rather confirm and preserve a plurality of norms and laws, especially those proper to, say, trade, religion, family, land, etc, or to specific sub-groups (the nobility, inhabitants of free cities, the clergy, religious minorities, etc). The hierarchy of norms and jurisdictions is thus fragile and partial — a pattern that reflects both a low level of political integration, limited competition between individual and collective agents and low contestability of economic and political markets. Agents are typically born into a local public order that severely limits their ability to change position within the broader society: social mobility is limited and entrepreneurial projects are repressed.

Despotic and Liberal constitutions thus present greater contrasts in the potential for economic activity and growth. Under a Despotic constitution, inherited inequalities and a fragmented legal order oppose strong resistance against the extension of competitive forces. Because inequality of status is a major obstacle to the extension of competition, open competitive markets will remain at best peripheral. Long-distance trade will be typically governed by ad-hoc legal rules and jurisdictions, which often present a clear extra-territorial pattern (think of the *Lex Mercatoria* and fair courts of the late Middle Ages in Europe).

Conversely, a Liberal constitution offers more scope for market exchange, growth and social differentiation because equal individual rights drive the opening up of markets and challenge the existing distribution of wealth. Abstract, universal and individual rights, as opposed to

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<sup>9</sup> Think for instance to early modern, absolutist France where the absence of constitutional guarantees to investors made it hard and costly for the State to raised debt (North and Weingast, ...). Timur Kuran (2005) also shows how, in the traditional Middle-East, the fragility of all types of property rights against extortion left wealthy families with only one safe, financial vehicle – the religious foundation, or *Waqf*. The problem, he emphasizes, is that did allow for the emergence of dynamic, profit-oriented, early capitalist corporations, that could have supported capital accumulation, innovation and growth.

communal solidarities and a fragmented legal order, thus seal the alliance between a Liberal constitution and the extension of market forces. Moreover, only a rule-based state will have the resources and legitimacy to guarantee market access and fair competition, and invest in market infrastructure. The “legitimacy loop”, which supports the long term dynamics of political development, is thus paralleled by an “economic growth loop”: single market rules and public infrastructure that support trade nurture increasing wealth and political legitimacy. This alliance between Liberal constitutions and market economies explain why Liberal constitutions are typically fought for, written and defended by either traders primarily interested in the extension of market forces, or by citizens of the emerging Liberal Republic, who are primarily motivated by the ethical imperatives of liberty and equality, as opposed to traditional orders and vested interests. Of course the balance between these two driving motivations to reform will affect the exact writing of the future constitutional contract and its dynamic over time.

#### **4. The dynamics of constitutional order-building: the analytical model in its historical context**

So far, we have developed step by step a framework for analyzing public or constitutional orders, as opposed to private or local ones. Though in both cases the logic of delegation is based on the same set of agent-based hypothesis, we highlighted a contrasted pattern: exiting a private order is not supposed to be costly, while opting-out of a public orders may be costly. Then the risks of coercion and extortion are high. This helped us contrasting Despotic and Liberal constitutions, where the *ex ante* definition of individual rights between core and fringe-members of the polity are respectively unequal and equal. And from there on, we identified alternate dynamics of rights and social enfranchisement, which allow for more or less extended economic competition and political participation.

We now want to apply these analytical categories, in two contexts: the economic take-off of Western Europe, from the early-modern period onwards; and the comparable experience of developing countries today. Beyond an appraisal of the leverage of our categories, the point is to understand how the dynamics of rights and social autonomy actually works, empirically, at the microeconomic level. Specifically, we want to better understand, in these two contexts, the transition between the two opposite models of constitutions, hence societies. With this aim, we start from the logic of constitutional bargaining and then address two complementary dimensions of state building: the construction of a binding hierarchy of norms and rights, and that of state administrations. In so doing, we take up from the proposition put forwards by North, Wallis and Weingast that the organizational form and reform of states in a key factor in development. In fact we just develop on this basis with our analytical language.

##### **4.1. Four Historical Eras**

Empires like Rome, Baghdad, or Byzantium were typical macro-scale Despotic orders, which degree of political and economic integration remained limited. The center imposed levies, enforce minimal common rules and ask for military contributions. Beyond, it formalized or at least recognized much differentiated local communities, which package of rights and privileges reflected closely their political distance to the center. Rights were then unequal vertically (between core and periphery) and different horizontally (between communities). As a rule, local economies also remained close to the household or *oikos* model: they generally showed strongly integrated social, economic and religious elements, and were rather adverse to commercial or moneyed transactions. Therefore, economic growth, social differentiation and political integration were limited.

Typically, this political structure also supported long-distance, inter-community trade, where its rulers saw a source of resources and wealth. Assyrians (Larsen), pre-Islamic (Ibrahim, Croone, Schemeil, 1999) or early Islamic societies (Kuran 2003), or Ancient Rome (Finley, 1966) did offer a number of economic institutions — insurance, debt contracts, mortgaging, etc that supported commercial exchange. Within the Aztec empire rulers protected commerce and expected substantial benefits from it in terms of wealth and authority (Duverger, 1979). But in each case, competition and individual economic rationalization were not tolerated within the local/communal orders and trading activities were closely monitored by rulers. Hence, wealth accumulation at the center could be staggering but growth was bounded.

After the collapse of the Roman Empire, alternative political orders emerged only slowly in Europe, around much smaller and less powerful centers, out of which feudal kingdoms progressively grew. A sustained recovery in income, trade, institution-building and technological innovation then supported the cultural and urban revolution of the late 11<sup>th</sup> century, which has been much studied by historians. On the one hand, the feudal and manorial institutions slowly developed into formalized bilateral commitments: for instance, personal obligations towards rulers evolved from physical to monetary transfers, and the rights of serfs and farmers became more precise – especially as regards their rights to land (Berman). On the other hand, the wealth accumulated in major urban centers by traders and artisans allowed them to negotiate new, indeed revolutionary, delegation contracts, either with the local nobility or with the Emperor. These contracts formalized the new status of cities and trader communities as semi-autonomous polities: though they were nominally part of the overall legal and political hierarchy, and had to pledge loyalty to the ultimate enforcer, delegation allowed them self-governing institutions and a capacity to design specific norms and institutions.

This autonomy was reflected of course in the guilds, though also in more universal, cross-sectional institutions like traders court. They were typically elected and self-managed, though they benefited from statutory enforcement guarantees; and appeal generally took the parties to ordinary civil courts. Of course the limit of delegation could be contested, for instance when public authorities believed that market disorders might cause public troubles (e.g. in the case of a banking crisis)<sup>10</sup>. The point, however, is that this framework of constitutionalized and delegated autonomy became instrumental in supporting institutional change. Foreign, Middle-Eastern-like legal institutions could be adopted — like the exchange letter and possibly the *commenda* contract — and new, revolutionary ones were invented: banking and monetary techniques, insurance contracts, bankruptcy proceedings, modern corporations, etc. Critically, courts confirmed limited liability corporation, or private arrangements under a bankruptcy procedure, though without interfering into the actual content of these operations. A strong but limited delegation of public regulatory powers to a single component of society then allowed it to design a second-order constitutional rule; and, for the first time ever, this rule was based on a clear-cut, de facto Liberal opposition between public and private realms. Regulatory powers took care of the collective interest and guarantee private rights, so that agents would benefit altogether from considerable social autonomy and from powerful enforcement security. This new, strong delegation contract then allowed them to develop strategies explicitly geared towards efficiency and profit.<sup>11</sup>

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10 Mueller R. C. (1997), *The Venetian Money Market*, vol. 2 Banks, Panics, and the Public Debt, 1200-1500, Johns Hopkins University Press, Baltimore and London, 711 pages.

11 Many authors claim that this breakthrough is a specifically Western European innovation. If this statement were true, it would indeed account for the divergence with other world regions, whether in the Middle-East, China or India. However, there are alternative accounts of Western exceptionalism, as in the comparison between Europe and China – since the latter was militarily unified with an iron glove, many sources of development were lost into unending battles; whereas the former remained sufficiently decentralized all along the first period of its economic development to allow constitutionalization of each political unit (Tin Bor-Hui, 2006).

These remarkable institutions remained however a protected, well-delineated sub-part of surrounding Despotic orders. The new individual rights of traders were not be extended to farmers (free-holding or not), nor to ecclesiastics, to the nobility or most craftsmen. They were only apply to specific agents, at specific places, like large trading hubs, and possibly at specific times, in the case of international fair and their own ad hoc, trans-national customary legal order: the Merchant Law. The “Westphalian moment” would then redesign this constitutional framework and better serve, eventually, the interests of traders and manufacturers. Though it is generally interpreted solely in political terms, as a delegation of sovereignty against security, this bargain most clearly extended to market exchange: property rights and contractual commitments were at the forefront of social pacification, as Hobbes and Locke most clearly stated.

The emerging national states then engineered a sharp redefinition of the old economic geography. On the one hand, long distance trade became international trade as we know it: a set of transactions governed by agreements between states that mirror the new Westphalian regime of international relations. On the other hand, mercantilism also called for national economies to be integrated by unified domestic markets. A multitude of closed, non-competitive, local economies were slowly opened up and integrated, so as to support division of labor, growth and tax revenues. The individual, competitive rights of traders were instrumental in this process. Their specific institutions were now offered all the time, to all traders, while the monarchy also offered new, powerful guarantees of execution across the country. Hence the key role of judicial integration, that allowed judgments to be enforced all over the country. Support to impersonal exchange and equal rights were indeed the two driving principles on which market integration rested.

How these delegated regulatory orders were negotiated was of course hugely influenced by local conditions: competing institutions, the strength of the respective new or old players, the pressure of traders for better market structure, their relations to political entrepreneurs, etc. In England, from the 16th century onwards, ad hoc commercial jurisdictions were progressively marginalized by the Common law courts. And, from the early 17<sup>th</sup> century onwards, the latter absorbed the old Merchant Law and thoroughly redrafted it with the vocabulary and legal principles of the Common law.<sup>12</sup> Traders, financiers and later manufacturers then established their fundamental rights and political interests, as they progressively entered the post-Glorious Revolution constitutional pact. At least three remarkable evolutions had then been slowly implemented: the ad hoc rules and norms of traders were integrated into an integrated, national legal order built primarily around the Common law; individual rights to trade and compete were extended to the whole population; and the considerable resources that had been conferred to the King (like taxation and market regulation, to start with) were now balanced by strong constitutional guarantees. In other words, the sovereign brought all its power beyond the defense of property and contractual rights while not being infringing into citizens and traders’ rights. Hence the dynamic of individual enfranchisement and the extension of the provision of public goods, that progressively extended to the lower, dispossessed classes.

In France, the failure of regulatory reordering before the Napoleonic era also revolved, to a considerable extent, around legal and judicial integration. On the one hand, the legacy from the Italian and international fairs was confirmed and formalized at an early hour: between 1667 and 1673, the Monarchy reformed and strengthened the existing, elected, largely self-managed traders’ courts; and it then wrote the basic customs of market exchange into the first ever Commercial Code – the *Ordonnance du Commerce*. Rules governing the exchange bills or bankruptcy for instance would apply under the same terms all over the kingdom, while the

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<sup>12</sup> See

enforcement procedures, in courts, also converged<sup>13</sup>. Codification hence clearly aimed at “formal rationalization” (in Weber’s sensewords), while also being a force behind the economic unification of the Kingdom.

The problem is that the monarchy, specifically the early element of a modernizing, meritocratic administration, did not proceed much further. They were certainly keen to protect the delegated constitutional contract of traders, though with some monitoring. More generally, they also supported a modernizing and centralizing project where legal unification and a streamlined judiciary would have supported both a more integrated nation and a rationalized state and fiscal machinery. But as Tocqueville so clearly demonstrated, this governing elite, that was very close to the liberal intelligentsia of the day, just failed to extend equal rights under a liberal constitution. As the rights to compete and contest extended, traders and citizens actually sized them, although Despotic patterns opposed forceful resistance (Rosenthal 1998, Mousnier 1974). The modern, individualistic rights and jurisdiction of traders were constantly under the threat of patrimonialist civil jurisdictions and regional supreme courts (the *Parlements*). Beyond, the unification of civil law across the country, the abolishment of domestic tariffs, not to speak of guilds and farmed-out officialdom: all these feature of a fragmented political and economic order remained until summer 1789. The result was a regime that constantly balanced between arbitrariness and paralysis, as the extension of equal rights and the parallel emergence of constitutionalized, liberal rule remained partial. Remarkably, from the very first hour, the Revolution was then fought in the name of very compact notions of both sovereignty and equal rights.

Fifteen years later, a new, rationalized hierarchy of law and courts actually formalized the defining interaction between private and public, as between contract and statutes. The 1804 *Code Civil* established a unified, property-based, individualistic legal order. It remained the benchmark example of classical, liberal legalism while the much less notorious *Code de commerce* merely up-dated the founding 1673 *Ordonnance*. And by the same token, while the old royal judiciary had been abolished very early, during the revolution, the early-liberal traders’ courts remained basically unchanged.

#### **4.2. One constitutional agreement and two amendments**

The initial, absolutist version of the Hobbesian contract was a unique and very powerful settlement, though also a very simple one as far as economic transactions were concerned. In fact it only traded civil and commercial security against taxation and allegiance, and did not attempt to shape “market outcomes” and orient them towards some politically or socially preferred results. Those elementary rights then proved a powerful, often revolutionary force beyond the unification of national policies and economies. And as local and traditional orders were steadily eroded or even destroyed, agents were emancipated and, if endowed with enough resources, they became increasingly autonomous and competitive – our second long term trend. This was typically reflected in an increasing entrepreneurial and innovative pressure in the economic sphere, and growing participation, or contestation, in the political realm. This experience had indeed a dark side as the brake-up of local communities and their often informal solidarity networks actually caused large-scale social distress and dislocation. Social marginalization and social repression were, in all Europe, a defining part of this early “liberal” or even libertarian order, especially after the old supply regulations had been shelved (tariff protection, guilds, etc).

From there on, two major constitutional amendments were added to this most basic,

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<sup>13</sup> See Hilaire, J. Y. (1985), *Introduction historique au droit commercial*, Paris, PUF, 1986, 355 p.

A separate case is that of special laws, governing some professions or economic activities (for instance financial ones). Ad hoc courts have certainly survived, and even developed in recent years, though their legal capacity is confirmed by sovereign.

revolutionary Liberal constitution. First, a Bill of Right was added in England, then in the United States and France. Absolutism was abolished as citizens imposed strong constitutional guarantees to limit the rights of rulers, while legitimizing them. The basic rules of a privately-driven economy (property rights, freedom of contract,) and human rights or *jus cogens* (habeas corpus, rule of law) were thus bound together in a new constitutional contract where the liberal public/private relationship was extended from the economic to the political realm. The latter extension of universal suffrage then further increased the legitimacy of this political contract. And as delegation extended, the sovereign became more widely recognized as the ultimate provider and guarantor of basic rights. The principle of equality in rights, that had been stated in the most general and abstract terms, was indeed taken over by generations of outcasts, as they fought for increasing their franchise — labor and socialist movements established the paradigm from 1848 onwards<sup>14</sup>.

On this basis, a second constitutional amendment was slowly written, from the latter decades of the 19<sup>th</sup> century onwards. With industrialization, urbanization, democratization, plus the emergence of a large working class, and early elements of a consumer society, the demand for a more active management of the economy became more vocal. By the mid-19<sup>th</sup> century, for instance, travelers were first protected against the hazard of train travel and consumers against bad food; later labor market regulation came to the fore, with competition policies or banking regulation for instance (Caprio et Vittas 1979, Golding et Libecap 1994). In, the aftermath of each World War, Western governments further extended the reach of public policies, on the basis of both interventionist supply-side policies and Keynesian demand-side macroeconomic management.

Market externalities and the demand for an extension of basic rights, specifically by the disenfranchised, were the driving forces beyond the development of Policy making state. However, as the demand addressed to the state meet the legitimacy and the resources to supply new public goods, the state-as-an-organization grew at a sustained pace. Most European countries had developed streamlined, permanent bureaucratic states over the 19<sup>th</sup> century, though they remain quite narrow. Their large-scale extension started only at the end of that century, or more clearly during the two post-world war periods. During at least the first half of the 20<sup>th</sup> century there was indeed a widespread argument that public and private production functions were actually converging: large corporations and bureaucracies were developing along closer lines as regard their internal hierarchical organizations, while the impact of different governance system became less tangible. Although the “Liberal reversal” of the late 20<sup>th</sup> century most clearly reflected the opposite principle – these are different worlds — a set of shared organizational principles remain to this day: division of labor and specialization, issues of economies of scale, meritocracy, formal depolitization, command and control chains, reporting and accounting rules. On top of being generally a monopoly provider, public administrations are also depositors of the common interest, which is another reason why they cannot be driven by a straightforward, efficiency aim. This constraint is intrinsic to the initial Liberal pact and explains why the production function of public goods is specific. And of course this makes them vulnerable to rent-seeking strategies as competition, by definition, cannot be as easily mobilized<sup>15</sup>.

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<sup>14</sup> In this sense, although our analytical language differ very much from that of more holistic or macro-oriented sociologists, or historians, we do not contradict here the approaches defended for instance by Tilly (1990), Moore (1966) or Anderson (19) or Skocpol (1979)

<sup>15</sup> Political competition being the solution

**Figure 1: The Consistency of Social Contract Regimes**

Social contract	State model	Category of norms	Ultimate guarantor
Coercers/ producers pact	Post-1648 Leviathan	Contract enforcement	Civil courts
Bill of Rights	Classical Liberal State	Natural rights/ rules of Justice	Supreme Courts
Liberal-Social-Democrat	Policy-making State	Protocols and policies	Parliaments

### 4.3. Various Paths of Transition?

The simple dichotomy between Liberal and Despotic regimes should have some leverage when comparing today’s developing economies, at least as a typology. Open market, competitive, rule-based politics, state-building, integrity of public administrations: these concepts which we have already used, are also very much present in the specialized literature as in the policy debate on development. The underlying question, however, is to what extent the dynamics of constitutional bargain that was identified here can account for trajectories, or at least basic scenarios, the way they have helped us interpreting Western Europe’s own transition. Of course, we do not assume that there is a single road to development. As already stated, things are quite different if only because a substantial part of these countries basic legal apparel was transplanted under colonial rule. Moreover, these experiences extend over a few decades whereas the previous discussion covered centuries.

We shall now proceed in two successive phases. First we focus on a very short time-span, namely the last twenty years or so: a period marked by rapid market reform, economic opening and, sometimes, democratization. We illustrate how our analytical categories indeed help describing the huge changes observed since then, in so many countries. Specifically, our endeavor is to rely on our analytical framework to assess the sequences of reforms in the light of the radical liberal, market reform, while keeping in hand both the economic and politic dimension of the underlying evolutions. In the last section we then try to identify various “packages” of rights, which would actually be the objects of the dynamics of constitutionalization. And as the latter would extend in different directions, it would actually account for various strategies, and possibly various classes or models of developing economies.

#### 4.3.1. History since the late 1980s’ – the Hobbesian revolution once again?

This second historical sketch starts from most common statement: by the mid-1980s’, most societies, in the South and the East, were stuck with a near-bankrupt economy, incompetently governed by a near-, or fully-despotic state. Hence, senile, prostrated Communist regimes or military thugs on the one hand; and centrally-planned or protectionist, corporatist economies on the other. Think to Soviet Union and Argentina. To varying degrees, individual rights were explicitly unequal between core and fringe citizens, access to voice was at best constrained, economic competition was impossible or highly-regulated, the provision of public goods highly deficient. Typically, the brake-down that opened the door to reforms was collapsing living standards in the East, debt crisis and high inflation in the South. Underlying illegitimacy brought down rulers, but reforms were then considered that did not come up on the agenda in Europe, for instance, where economic over-regulation did not have such adverse effects.

Systemic reforms then started with the equivalent of a new “Hobbesian revolution” — rapid or not, violent or peaceful. Legitimate violence and the power to coerce were put under the control of constitutional rulers. The civil commitments of the Leviathan and core individual rights were sharply redesigned. First, states rapidly refocused their mandate on strengthening

the basic institutions needed by any open-market economy (fair competition constitutionalization). Think to monetary stability and the reform of Central banks, fiscal federalism, contractual discipline, the basic operation of goods and factors markets. This indeed describes a fair approximation of the minimal, laissez-faire state. Second, agents were endowed with new individual rights in a process that de facto mirrored, though at a much more rapid pace, the individual enfranchisement observed in previous centuries in Europe. Exit from the neo-corporatist or socialized orders was obtained by granting transferable rights that allowed coordination by mostly market instruments. Think to the supply of jobs, housing, credit, domestic heating, equity shares, western jeans, hard dollars, bank deposits, saving instruments, arable land, commercial estate, sport equipment, international flights.

The central issue is not that states withdrew from a huge number of production lines and transferred them to “the market”. Individual rights were the true revolutionary force that actually broke down a mass of solidarity networks, cross-subsidy schemes, protective niches and other local orders, whether they were oppressive or friendly, hierarchic or egalitarian. This not only allowed private entrepreneurs to come in where the state had left; this primarily opened to competition the supply of goods and services that had been offered until then by non-contestable, poorly efficient organizations and rulers, many among them immediately lost their weak delegation contract. Indeed, the “Hobbesian revolutions” resulted in sharp, even brutal polarization being operated between the public and the private realms. It not only wiped a great number of past economic institutions, it also destroyed a large part of the intermediate, sub-national organizations that had structured social and economic life under the previous, corporatist regime. The immediate results were at best individual autonomy, economic competition, political contestability, renegotiated delegations and elite renewal. But again, part of the experience was also impoverishment and social marginalization as many agents, had not the resource to adjust and make a living under the new conditions – think to pensioners or to the low qualification workers of past socialist industries that were discovered to deliver negative added value at market prices.

Clearly, this revolutionary experience did not result in the same degree of constitutionalization of individual rights in all countries. China, Russia, India and Brazil, to take a few, offer quite different experiences as regard both the civic and economic rights to contest and compete. However, as compared to the post WWII period, the evolution toward stronger and more equal economic and civil rights deeply transformed both the economies and the polities. In many countries, the result was altogether more growth and more ex post inequalities, more open rules though no mercy for the losers and the poorly-endowed. Even the actual rights to challenge incumbent producers and rulers diverged substantially, from the onset. We actually defend that post-1990 liberal experiences can be analyzed as the unfolding of alternative trajectories, out of this founding experiment. The following years then witnessed successive generations of reforms that actually echoes the constitutional amendments discussed in our survey of post-17<sup>th</sup> century Europe. First, market crisis, most typically the emerging markets meltdown of 1997-1998, made clear that the institutional prerequisites of a stable, growing market economy are much more demanding than had been considered initially, when only pro-competition reforms were on political agendas. Financial crisis, two to four years after liberalization, imposed in many countries a root-to-branch reconstruction of both the private and the public regulatory institutions that support credit and securities markets. Other examples are mechanisms that support firm entry and exit, anti-trust and competition policies or the delegated regulation of specific markets (like utilities). These reforms then have two main objectives: they regulate potential market externalities, and they should practically guarantee the long run constestability of markets. If they fail on the second count, for instance, then the oligarchic syndrome may rapidly emerge, which would rapidly



oppose considerable obstacles to further reforms. Like in post-1990 Russia, first movers may concentrate massive rents from entering non-competitive markets and then attempt to capture the regulator and foreclose new entry (Hellman, 1998).

On the political side, equivalent, second-generation reforms followed on early democratic transition (free election, division of powers, free media, etc). They cover, for instance, local democracy, judicial reforms, the fight against corruption, etc. On both accounts — economic and politic — support or resistance to these second-generation reform responded to crisis and to the organizing capabilities of the respective constituencies, hence to their resources and capacity to address policy-makers. Defenders of market access for SMEs, or democratic control of local leaders, do not necessarily have easy access to rulers. If oligarchic elites enter at an early hour a close compact with the rulers, access rights may be actually denied to them. The assumption we derive from our analytical model is that the distribution of initial rights, and the way new individual and collective agents invested them, did influence heavily the ulterior reform paths.

The third wave of reforms has been on the agenda for a few years only. After the revolutionary breakthrough, followed by more incremental liberal reforms that institutionalized market stability and open access, governments have been increasingly pressured to deliver a larger and more diverse set of public goods. In other words, they are entering the policy-making phase entered into by the liberal European states, at the end of the 19th century. Here are mainly the four, canonical post-Washington Consensus policies that have now become worldwide priorities – education, health, poverty reduction, and environment. What characterizes them is that they: 1/ do not have clear, private-sector alternatives – they are to a large extent pure public goods; 2/ they require finely-designed constitutional rules so that the interaction with decentralized actors, specifically market ones, will not become dysfunctional (think to environment for instance); 3/ their management is highly intensive in modern technology, human competences and coordination know-how.

#### ***4.3.2. The constitutional bargain and the production function of state organizations***

Thus, to a large extent, the story of the 30 last years in many countries started with more or less comprehensive Hobbesian revolutions: citizens, traders and entrepreneurs were endowed with rights that allowed to challenge the pre-existing orders, both the incumbents and the rule they were sponsoring? Large-scale transformation of the economy and the polity were the main results. This was followed by a progressive, differentiated extension, equalization and strengthening of rights to security as of rights to compete. The resulting growth led progressively to new pressures to constitutionalize packages of social and political rights, which are under discussion today in most emergent countries. A complex combination of social interests calls for the development of these rights. The raising middle class for instance is strongly pushing for democratic reforms and often seeks to extend its voice over the decision process and the distribution of public goods. It also calls for extension of its social rights to get the protection that disappeared with the collapse of the traditional social networks and communities. Entrepreneurs and traders are however also interested in social packages. The reduction of poverty, the development of social insurances, the provision of education, public infrastructures, macroeconomic policies, etc. concur to favor the development and stability of the internal demand or to the strengthening of the international competitive position of the country.

On the other hand, the underlying demand for more rights and more public goods also entails a consent to pay more taxes, hence a collective judgment on the efficiency of the public production function. Unreformed bureaucracies or those, reformed or not, that are considered

corrupt, or overly controlled by rent-seeking interests, may then affect the dynamic of constitutionalization. As the first proposition of our model made clear, delegation contracts are bargained over on the basis of a cost-benefit trade-off. And because public administrations cannot be out-competed by market mechanisms, voice and political participation are the only solution. Another example of this micro-level interaction between agents and state organization revolves around the so-called informal sector. The large, often majority, part of the population that, in many countries, live outside the protection of the law, without proper civic and economic rights, embody a massive constitutional failure. They just remain outside the initial Liberal pact: insecurity, adverse economic condition, reliance upon local private orders are the typical responses. Moreover, ulterior, second and third wave reforms hardly reach them. What is the point of building a secure, working banking system, or a state-of-the-art anti-trust regime, or modern environmental regulation, if half of the population is beyond the reach of the law? Following partly on the well-known thesis defended by De Soto, Maloney (1998) actually demonstrates empirically that opting in or out of the law-based constitutional system is a matter of individual trade-off. And the micro-economic reason beyond is the fixed (non-proportional) costs supported individually by agents that interact with public institutions. The poorer the agent, the less able he is to support those costs in order to benefit from the actual services that the more or less benevolent sovereign has to offer.

Hence the evolving discussion between agents and their rulers. First they may consider the possibility that more devolution of powers and resources may translate into better market infrastructure and increased provision of valuable public rights. Then, the constitutional guarantees citizens expect to receive will progressively extend well beyond the classical Bill of Rights and other reverse commitments entered into by the Leviathan. As a more diversified set of policies are being discussed, the constitutional bargain extends to the production function of public goods hence to the working of state organizations. Here are issues of competencies, know-how, capacity to manage information, etc., *plus* one, defining, public criteria: fairness or, more precisely, equal rights. As citizens trade-off the respective benefits of private and public provision of services, they most clearly expect that the resources they cede to the ruler will be used in ways that actually reflect this founding principle of liberal polities. If they believe that these resources benefit only the happy-few, or some cliques of insiders, the legitimacy of taxation will be lost and the constitutional contract will narrow. In other terms, if the production functions of private and public goods both exploit the economies of division of labor, they remain ultimately founded on alternate principle that actually embody the founding opposition between common and private interests, or between joint rules and private benefit.

While this general evolution is observable in most countries, it is clear however that some did not choose — or were unable — to constitutionize with the same strength and at the same pace the various packages of rights. Also, priority among packages has not always been the same.

## 5. The Challenges of Development

Our aim is now to turn our theoretical and historical analysis in a more applied one aimed at pointing out the policies and their sequencing that should favor transition to an open access society and therefore development. We point out that the rationalization of the state and its establishment as a neutral/benevolent actor are essential to guarantee the constitutional pact and empower citizens/traders (section 5.1). To go further we differentiate four sets of rights that should be constitutionalized to guarantee the raise of an open access society. These four packages correspond to well recognized dimensions of public policies (section 5.2). This allows then identifying key policies in the process of development (section 5.3). Then the

sequencing of the implementation of these policies is questioned (section 5.4). We therefore analyze the various doors to go through to allow development.

### **5.1. The state's capability as a guarantor of the constitutional pact**

We fully agree with North, Wallis and Weingast that development is not a series of outcome but a process linked to the transition from a limited access order to an open access society. We believe, however, that our understanding of the constitutional pact as a pact between the elite and the non-elite, rather than a pact within the elite, proposes a better understanding of the drivers and inhibitors of the evolution of this pact, and therefore of the alternative paths of transitions. Indeed, fully in line with the argument made by North, Wallis and Weingast, the key factor of transition is the transformation of the state, this organization that in a natural state is captured by the elite, into an impersonal and independent organization sustaining impersonal exchange at all levels of the society.

The “doorstep conditions” identified by North, Wallis and Weingast to allow this great transformation lies in the ability to develop a state characterized by checks and balance and a reliable bureaucracy, these two characteristics self-reinforcing each other. The role of check and balance within the polity is to prevent irreversible and full capture of power by any individual or group of interests, so that the recognition of each other rights between members of the elite remains credible, while impersonal and no longer based on a fear equilibrium (which induces strong investments in capability to exercise violence). The role of the reliable bureaucracy is to raise taxes and enforce regulations so as to provide the elite with the rents they are seeking for. Economies of scale and of specialization allow elite's members benefiting of rents at lower costs. The bureaucracy is also a machinery aimed at redistributing part of the rents to the non-elite to make the social order acceptable. We share the idea of the causality link between economic transition or take off and the development of a “modern state” in the sense just described above for two reasons. First, we agree that the dynamic highlighted by North, Wallis and Weingast is the driver of the adhesion of elite to the modern state and its consequences, in particular the rule of law and the control of the armed forces by all means of balances. Second, following our own reading of the constitutional pact between the elite and the non-elite, we see accountability in decision making and efficiency of public bureaus as credible means to guarantee the delegation of authority from the members of the society to the rulers. If the combination of (fair) processes of consultation of the electorate with horizontal (and vertical) division of power guarantees the capability of “voicing” to all stakeholders, and if an enough skilled and organized bureaucracy guarantee actual implementation of collectively agreed rules and the efficient production of public goods, then incentives to exit the constitutional pact are low, and the pact becomes self-sustainable. It is then able to provide the infrastructure for both impersonal exchange and the development of all kind of organizations.

It is worth pointing out that, while slight (while compatible) differences explain this, both North, Wallis and Weingast and us see the question of the development of a modern state as the condition to development. Of course, neither us, nor North, Wallis and Weingast have a vision of the society according to which an efficient state will easily build the infrastructure of a market economy that will be progressively be learnt both by the elites and the masses for the benefits of all. We all recognize that informal institutions and beliefs matter, that fear for sanctions is not all, and that individuals have to adhere to institutions, that there are always incentives to coalize to bypass an order, etc. Both in North, Wallis and Weingast's theory and in our approach, building the state in a context of transition is a central issue for two reasons. First, being an organization, the state can be transformed, can be the object of political agreements, which is not the case for many other components of an institutional system.

Second, timing matters. While it took several centuries for European countries to build the modern states sustaining developments, it can be hardly sustainable — primarily in terms of international order, not to speak of ethic — to let the countries trapped in a limited access order (which result in disorder and violence), experience the same long and winding (and bloody) path of development. Thus the vision proposed both by us and by North, Wallis and Weingast does not draw at all from a 1960's (and 1990's) vision of economic infrastructure building. The state is understood as the guarantor of a constitutional pact and the problem of transition is to allow transforming existing pacts into what we qualify as liberal constitution by which equal rights are guaranteed to all. While North, Wallis and Weingast insist in this process of the extension of the logic impersonal rights from elites to the masses, we insist on the process of erection of the state as the legitimate guarantor of individual interests, as the holder of the collective interest, and as a tool empowering individuals to enable them to actually exercise their rights.

Indeed we see the process of transition/development as a process by which the emergence of a credible guarantor in last resort of the fundamental rights of the citizens allow them to exit the traditional/local/informal orders, which brings them the benefits from deeper social division of labor and better shaped collective organized action. However, these benefits, which may raise switching costs and redistribution during the transition, and wider individual uncertainty ex-post (because of the generalization and deepening of competition), can be accepted if and only if the guarantor does not only provide an empowering infrastructure. It should in addition credibly provide public goods and, before all, manage security and solidarity (to balance, respectively ex-ante and ex-post, the consequences of a society of wider individual responsibility). To put it another way, the issue of development is to guarantee a credible public order guaranteeing individual rights, policing while strengthening competition (both economical and political), and managing efficiently collective solidarities, to allow all members of the society to benefit from resources and incentives to bypass local and informal rulers and orders who generate deadweight losses and sustain the persistence of violence and insecurity; the later explaining why despotic constitution/natural state may remain a stable equilibrium. Below, we explain how our framework helps analyzing various processes of transition.

## **5.2. Four Domains of Constitutionalization**

The process of transition is not a radical or grand transformation, from one equilibrium to another (i.e. natural state to open access society), but a more gradual one that can occur along different paths and following different sequences, as it is clearly illustrated by the contrasted strategies of China, Russia, Poland, Brazil, India, etc. To analyze the contrasted pace and paths of various trajectories, we refine our framework by identifying various “packages” of rights that can be included or not into the constitutional pact.

More precisely, recognizing that the constitutionalization dynamic is a matter of contractual delegation between the stakeholders and the rulers guaranteed by bureaucratic machinery, we contrast two states. A first one corresponding to the natural state/despotic constitution in which individual rights are weakly established. This can be due, first, to a poor and narrow definition of rights, which means that impersonal rights are not recognized and that most rights are personal depending upon individual/coalitions capability to bargain to make them clearer and enforced. It can also be due to the fact that formal impersonal rights are clearly stated, but de facto not enforced because no state machinery is able to ensure compliance, leading members of the society not believing in them and not recognizing the legitimacy of other's rights since nobody's rights are really opposable to others. To the opposite, there is the situation corresponding to the open access society/liberal constitution in which individual

rights are wide in scope, tend to be equal and impersonal, and are strongly established in particular because they are guaranteed in last resort by an efficient service providing bureaucracy that make these rights tangible.<sup>16</sup>

We now rely on our above-proposed dichotomy to analyze how various “packages” of rights are constitutionalized or not under different politico-economic regimes. Indeed an analysis single right by single right would be relevant to develop to discuss of each national path, but would be intractable. We therefore propose to differentiate four “packages” of rights — corresponding to four domains of socio-political issues — that can therefore be weakly or strongly established in a given national community. First, we identify a package of *basic rights to security*: from habeas corpus to property rights. All together these rights ensure the possibility of a market economy and of a civil society. Second, there is a set of *rights aimed at guaranteeing a fair competition in the economy* in the sense that they not only prohibit market foreclosure, but also ensure the impossibility of some market player to take control in the long run of the state capability to suspend competition here or there. This corresponds to the recognition of any entrepreneur’ right to provide a good or service (as long as non discriminatory safety conditions are met) and to the establishment of guarantees to a fair an open access to markets and collective infrastructures, and to the development of capabilities aimed at preventing manipulation by market players to distort competition and establish non-challengeable positions. In practice in goes from the establishment of a competition law and the divestiture of all sorts of barriers to trade, to the development of a set of independent and powerful regulatory authorities and courts. The third “package” is made of the *social rights*, which logic is twofold. First their development is driven by the economic logic of developing the domestic demand, favoring productivity gains (in particular by improving skill) and stabilizing the economy. Second, they reply to the unquenchable thirst for security and empowerment of citizens, who need guarantees against the hazards inherent to life but also to their individual dependency to others in a social system characterized by division of labor and risks of systemic crises. They start by a set of rights related to the hazards raised by the division of labor and by the development of impersonal exchange to socialize their costs (e.g. social insurances), reduce their magnitude (e.g. regulation of working conditions, of product safety) and extend to rights aimed at reducing the individual costs and magnitude of many societal hazards (e.g. minimal social revenue, right to a home, etc.) and include rights to a wide set of collective service provision (e.g. right to access electric and digital networks from any location on a territory). All together these rights materialize the recognition of solidarities among individuals, their interdependence and therefore the existence of a community of interest that justify redistribution (either pure or through the provision of public goods and services). The fourth package correspond to a set of *democratic rights* aimed at guaranteeing the actual taking into account of the interest of all the concerned stakeholders when making

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<sup>16</sup> It must be clear that this dichotomy is to simplify our reasoning. There is a continuum among these opposed situations. In particular, it could be refined by recognizing three levels in the establishments of the constitutional rights. At the bottom level, individual rights regarding an issue remain unspecified, meaning that the management of the related issue can only rely on informal arrangements or on the balance of strengths (not to say violence) among the involved parties. At the intermediary level, the constitutional pact does not propose a way to manage the issue, a rule for reaching a solution, but provide tools to allow the agents to negotiate. While compromise among diverging interests will be solved on the basis relative bargaining power, they will be peacefully solved under the oversight of the public ruler and its state machinery. Individuals rights are therefore de facto relative since their translations into ability to actually access or use resources depends upon local relational/implementation settings. Recourse to local and informal rulers is however not mandatory and the public authority guarantees agreements (even if unfair) among parties. The last level is when a right is no longer negotiable, in the sense that the beneficiary of a right no longer needs to bargain with his neighbor to establish is actual ability to access, use and deprive other from access to a resource in various context. The right is opposable, which does not mean that it is not tradable and transferable to third parties. We recognize that, at least these three levels of establishment of rights exist and that there are very useful to compare the situation in various countries regarding this or that domain of individual rights. For instance, what might contrast continental Europe from the US regarding the right to health is that the former establish non-negotiable rights to health (and even some un-waivable rights on the human body), while the later provide its citizens only with negotiable rights like legal means to cover the costs of medical treatments. However, we think that the essential contrast when dealing with the issue of economic takeoff/transition is when the public order is able to supplant the private one, initiating a hierarchy of norms, which is the case when we reach the second level of right establishment.

collective choices regarding either the design of collective rules or the provision of public goods. It correspond therefore to the implementation of the apparatus preventing capture or the ruling capabilities by some, and an unrestricted use of the authority granted by the citizens or their representatives to actual decision makers, and guaranteeing accountability. It is therefore the complex combination of individual (actual) rights to vote and to sue with the systematic organization of checks and balances within the organization exercising public authority, its obligation to be transparent and to perform through established procedures, the recognition of liability principles, which limit discretion in the exercise of power. It is what ultimately guarantees citizens against both the tyranny of some and the tyranny of the majority; legitimating the balance between individual and collective interests, both in the economic and political spheres, which appear to be quite intricate and difficult to disentangle and to rank.

### **5.3. Drivers and Inhibitors of the Evolutions of the Constitutional Pact**

As pointed out above, there are two drivers for the evolution of the constitutional pact on each of these four packages: the dynamic of the societal compromise and the development of efficient and neutral state machinery.

The socio-political compromise in question concerns the extension of the rights that are recognized to all and the magnitude of their (de jure and de facto) equalization. This is of course a compromise between the elite and the citizens. It has however to be understood more generally as an agreement among all citizens since, with the progressive development of the economy, there is a growing middle class. There are therefore at least three groups of stakeholders with potentially different level of rights and interests<sup>17</sup>. In any case, the drivers for the progressive extension of impersonal and equal rights to all citizens are twofold. First, the increasing division of labor (thanks to markets AND organizations) and the fostering of innovation (thanks to the generalization of the principle of competition AND the capability to accumulate collective knowledge in organizations) boost the surplus to be shared. Second, the provision of an increasing set of public goods and of automatic and systematic insurance or solidarity mechanisms provides individual freedom with limited individual risks. Note that it has consequences both in the “political” sphere and in the “economic”, which are in actual facts quite impossible to disentangle. Indeed the raise of “opposable” rights to collective solidarity allows individual emancipation and the building of collective beliefs, and impacts also on the capability to innovate and to reallocate assets in the economy. These are the reasons why traders as well as citizens, wealthy and poor, can agree on extensions and equalization of rights for all. While potentialities to compromise exist, there are nonetheless rarely spontaneous. Evolutions draw from conflicts among group or interests, and also from alliances among sub-groups of “enlightened” citizens and “enlightened” members of the elite who foresee the benefits of new social contracts.

The hindering factors are also twofold. First, there are redistribution effects. All kinds of individual rents are suppressed with the equalization of rights and the raise of competition. While the raising surplus allows in theory to compensate losers, the later might fear net losses. Also, while the consequences of uncertainty are increasingly socialized, uncertainty raises because competition makes any position challengeable and because innovation permanently question established ones. There is therefore redistribution between risk lovers and risk adverse agents. While attitude toward risk partly depends upon the level of wealth, it is also an in-depth psychological characteristic and a question of individual preferences. Thus,

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<sup>17</sup> Even more generally, while the dichotomy between elite and citizens is convenient from a didactic perspective, it hinders considerably the fact the elite is divided into, at least, the ruling elite and the economic one. Also, there are strong division between urban and rural populations, between owners and non owners, between educated and illeterates, etc. within the “masses”.

despite the development of impersonal collective solidarity mechanisms, risk adverse agents may fight again the extension of individual rights. Second, there are switching costs since with the raise of a generalized competition in the economy and in politic, individuals have to learn to play new games and to permanently make efforts (general contestability of all positions) and update their skill.

What has just been written highlights the need for efficient and credible state bureaucratic machinery. First, public bureaus have to be neutral because they must credibly guarantee the constitutional pact. They have to perform according to procedures guaranteeing an impersonal implementation of individual's rights, and thus escape the discretionary exercise of power. It is worth to note that the principle of neutrality can be violated in particular by three type of actors: those in power in the government; the various organized groups in the society which may exercise all kind of pressures on civil servants; the civil servants themselves who can exercise their authority on a discretionary basis. This later category raises immediately the issue of corruption (to be distinguished from the one of the political elite), if strong informal "moral" norms and beliefs do not prevent civil servants to play on organizational slacks to maximize their individual wealth instead of complying with the collective interest.<sup>18</sup> Second, public bureaus have to be skilled and well organized to efficiently implement the complex and wide set of rights of citizens. This cover the provision of all kind of public goods, but also the capacity to oversight the behaviors of agents in a number of domains to prevent infringement of the rights of the weakest by the wealthiest, or the most dynamic, or the most violent, or those gifted with strong bargaining position. While we recognize that any organization produces its own logic of self-justification and self-development, the development of the state is an endogenous driver of the evolution of the constitutional pact. It is an enabling condition. In the perspective of development policies, it is clear that the various domains of rights do not refer to exactly the same functions of the state.

The *basic rights to security* correspond first and foremost to the ability to develop forceful and non-corrupted police forces and the associated civil (including criminal) judiciary. This is partly a question of capability of the state to raise taxes to pay policemen and judge enough to prevent corruption. This suppose also a judiciary powerful enough to balance the strength of police forces and to oversight them. The second condition is a secure titling system for property rights, and before all for land and real estate. The later is indeed the very basis of any credit system through mortgages (Arrunada, 200X).

What appears to be the key issue in matter of *rights to an open and fair competition* is obviously the ability to oversight market performance and to take appropriate measures to influence the behaviors of competitors, and to do this independently. This corresponds obviously to the logic of the Washington consensus, with the emancipation, empowerment and specialization of the authorities supervising market activities. As in the case of the police forces and the civil justice, the key issue here is to be able to prevent corruption, to guarantee independence from the government, and to develop skill since highly sophisticated behaviors and issues have to be dealt with. While it is second rank, it is important to point out that the capability to decrease costs and facilitate entrepreneurship is also an issue. That is reducible neither to the controversial "speed in settling a new business" pointed out by the World Bank, nor to the regulations of the product or labor markets targeted by many OECD studies. Indeed, beyond the quality of the legal infrastructure, public authorities can manipulate taxes to decrease the cost of new-ventures and innovation. Moreover, they can favor access to many resources — and in particular capital and knowledge — by developing institutional infrastructure favoring trade among the heterogeneous set of agents behind innovation (i.e.

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<sup>18</sup> Of course, procedures and control mechanisms have also to be developed within the bureaucracy. They are both complementary and complement to moral norms.

entrepreneurs, technological innovators, capital venturers, investors in markets, scientific institutes, marketers, etc.). More generally, the ability to provide efficient infrastructures for economic activity and trade (from transportation to customs, and from the quality of the labor force to the security of the legal infrastructure) is important, while of course it is an obvious chicken and egg problem for development. The ability to provide access to infrastructure as seed favoring new entrants — as it is the case in Chinese “special economic zones” —, should however never be underestimated.

In developing countries, the *social package* relies before all in the ability to include the poors, both by developing essential infrastructures (including health) and by reducing illiteracy. The capability to raise taxes and operate redistribution is obviously essential. The next step is to develop a social security system managing in particular health and unemployment issues. The essential focus of unemployment policy should be to ensure employability, especially by training unemployed. Whether it is question of health, education or basic infrastructure, the issue is often less to rise funding and to choose the optimal way to distribute them (free services vs. bond, vs. increasing income), than to develop adequate organizations able to provide the services. Developing the capability to monitor the economy at the macroeconomic level is obviously a third issue.

Beyond formal division of power that tends to be formally implemented in most national constitution in our days, the “*strong democratic guarantees*” are fundamentally depending upon the ability of all the components of the divided state to balance each other, which means two things. First, each level and area of government should be skilled enough to be able to challenge the other entities with which conflict might occur (either because they must control each other or because they have different domains of competence). Second, each authority should be independent enough to de facto be able to balance all the pressure it is naturally submitted to. This relies of course on the ability to fight the “grand corruption” (as opposed to the front-line civil servant’s corruption that impacts on basic rights to security). This relies also on the ability to frame the political activity thanks to a system of really independent high courts. This relies, at last, on a secured funding of each component of the divided power, both to guarantee independence of the entity and attractiveness of positions (whether it is decision makers or supporting bureaucrats).

#### **5.4. Various Paths of Transition?**

Observing the world as it is, it is clear that the countries that have not yet adopted a liberal constitutional pact, are in very different shape regarding the process of constitutionalization of the various “packages” of rights identified in this paper. The question is whether there are dead-end roads and avenues. Our endeavor is to rely on our analytical framework to assess the sequences of reforms in the light of the raise of a truly open access order, in its intrinsic double dimensions: economic and politic.

We have been pointing out in this paper that the process of development is linked to a switch of the all society from an economy of rents to an open market economy. This switch is based on two (intertwined) pillars. First, the establishment of the rule of law, because legal instruments — and especially rights — can be appropriated by those who call for more freedom and autonomy, resulting in a progressive equalization of rights. Second, the development of a capable and impartial state, because it is the guarantor of an open and fair competition, both economic and politic. The combination of these two pillars empowers the members of the society. The collapse of barriers to trade enables the society to fully benefit from@ the social division of labor. The breaking of local despotic and clanic powers free individuals and boost entrepreneurial spirit. Is there any best way to get this virtuous loop under way? Our main assumption is that all four major packages of constitutional reforms



should be in place to ensure the sustainability and legitimacy of a liberal — a liberal-social-democrat — order enabling long term growth and sustained political participation. The successive steps in the process of reform now allow us to differentiate alternate scenarios, out of successive bifurcations.

The first issue is, as stated in section 4.3, the guarantee of basic civic and property rights, thanks not only to the passing of legislation, but also to the development of a competent and not corrupted police and justice, not mentioning robust titling systems. Clearly the states that are unable to impose their authority because of civil war lie behind and cannot expect any further evolution as long as basic security is not restored. This is also the case of kleptocratic authoritarian regimes like Myanmar and many central Africa states. Basic economic and civic rights being unsecure, economic entrepreneurs — unless foreigners protected by their bargaining position and their national government — and citizens do not benefit of any mean to ground and guarantee any type of initiative. In principle these situations are not sustainable, unless energy, mineral or narcotic resources allows the cliques in power to maintain their tyranny and to sustain conflicts among warlords.

It is of course more interesting to analyze what is going on when we are beyond this line, that is when civil peace is established and the state guaranteeing a minimal social order. The issue there is what happen in transition and whether the social order is available to all. One of the core points in a process of evolution from natural state to more open access society is probably the process through which property rights are redistributed. Think to Eastern Europe where collective control over assets practically broke down during early period of political transition. Public property then became a common good that was exposed to a tragic run. Clearly the outcome of this experience, how the state recovered control over its assets or not, and how they were transferred to private did weigh massively on the political and economic dynamics of the following. By and large, this remains the defining switching variable between central Europe and the former Soviet Union. Another example, also centered on the transfer of public property, has been, in many Latin American and Asian countries, the privatization of large public utilities: whether this took the form of private deal, a contested auction or an IPO would obviously weigh on the future political economy of the country. The point here is twofold. First, the transparency/fairness of the process of distribution of property rights is essential since it impacts on the ex-post strength and legitimacy of these rights, and therefore on the ability of the future political elite to capture them again, or to redistribute them to friends. The case of Russia with the Mikhaïl Khodorkovski's case is exemplary. A weak legitimacy of property rights drawn from the transition, led the new capitalist elite to be dependent from the political power, and prevented the autonomization of the traders from the rulers, blocking the process of actual development of an open competitive framework and preventing the business elite to be one driver of the confinement of the rent economy. The second issue is the polarization of the distribution. In those countries in which the distribution of former public assets was de facto reserved to some. Public monopolies were replaced by private powerful oligopolies. Moreover the concentration of market power and financial power in the hands of some favored the development of (grand) corruption of the political/judicial elite that made also impossible the opening of markets to actual competition, and more generally the ability of the state to overhang private activities to ensure compliance with any policy, from pro-competitive ones to environmental ones and including a limited ability to raise tax and fund therefore public goods provisions.

The second essential issue is the ability of the state to guarantee protection of basic civic and economic rights to all. In those area of the country or of the society where the state fails to guarantee security, especially because it cannot actually control police forces or because the judiciary is weak and unskilled, mafias or the traditional authorities are prompt to replace the

state and “sign” the basic Hobbesian contract with the poorest or those out of reach of the impartial state. This clearly hinders chances to allow the development of a competitive economy, of efficient organizations, of dynamic entrepreneurship, etc. both because of over-extortion by private rulers and because they want to avoid the development of any forces that could challenge their power.

It is worth to note that energy, minerals and rare raw material exporter-nations tend to favor the appearance of such symptoms. If indeed the main flow of resources upon which the state relies is not to be levied by the development of competition and the opening of the socio-economic game, then the incentives for the political (and economic) elites to push reforms are significantly weak. The virtuous loop of extension of economic and civic rights described above is very unlikely to start and to be fuelled by the development of entrepreneurship.

To the opposite, when a first set of secure civic and property rights are granted to all, and even if they are unequally distributed, the legal arena becomes central in the social game, since the law, the constitution and courts, become the guarantors of the pacts between the citizens and the state and among citizens. This results in a “mechanical” development of the rule of law. Agents want to have their rights opposable to the state (public law) and opposable to their fellow citizens (private law) more and more precisely defined, and of course extended. They rely on their initial rights to take actions aimed at getting more protection by the law. They also rely on legal grounds to manage conflicts. More generally they push for a translation into the law of the outcome of most social and economic interactions; hence the cumulative establishment and reinforcement of the rule of law. This is of course one of the main drivers of the adoption of the next packages, and in particular of the guarantees to fair competition.

The development of an institutional infrastructure guaranteeing the efficient performance of markets (low transaction costs) and a fair and efficient competitive process tends to be the natural next step. In addition to the actual autonomization of the law and of the judiciary from the executive — which can no longer discretionary manipulate the law and judges, especially because the society consider the legal framework as the core of their constitutional guarantees and no longer tolerate discretionary manipulation; the law being regarded as sacred (a question of collective beliefs and convergence of anticipations) — the key is the development of competencies within the state’s organizations. We indeed meet here the classical Weberian theme of bureaucratic development as the second typical trend in modern societies, in parallel with market development. Both developments reflect the same pattern of formal rationalization that translates, within administrations, into meritocratic, apolitical recruitment, intense division of labor, clear hierarchical lines and standardization. In Weber’s view, as in ours, this represents the typical operating mode of law-based, impersonal bureaucracies, as they take in charge the implementation of an increasing number of policies and common goods. Central Banks are probably in the developing countries, the institution that has developed the farthest in this direction, as is reflected by their high level of competencies and typically apolitical operations and recruitments in most successful emerging economies. The other key institutions for the establishment of truly open and competitive markets are the regulatory authorities and the anti-trust commission and, of course, the tax administration. Of course, the development of bureaucratic capabilities is also essential in other public policy domains — education, health, infrastructure, environment, research, etc. — but to a large extent their capability to provide public goods is strongly depending upon the taxing capability of the state and of the dynamism of the economy. The bureaucracy in charge of economic affairs is therefore crucial and is the first to be reformed and empowered.

The two last packages of social and political rights seem to come next and hands in hands from a logical point of view. The provision of packs of social rights is essential to guarantee

adhesion (of the less favored) but more generally to fuel the dynamic of growth. The social rights in question are those aimed at dealing with issues like poverty, education or environment. At first sight they are the rights necessary to compensate for the “damages of progress”. However in an endogenous growth and Keynesian perspective, they are the boosters of growth in a market economy, both because they boost the creation of collective capability — and in particular of human and organizational capital — and because they cushion shocks.

Beyond the development of an efficient bureaucracy to efficiently provide the relevant public goods, the enabling conditions for the appropriate design and implementation of public policies — from regulation to direct provision of public goods — in matter of “social rights” is the allowance of actual capabilities of voicing to citizens. Two reasons behind that. First, democratic pressure is essential to identify the needs and establish collective preferences. When democracy outperform, then incentives are high for all types of stakeholders to bribe the bureaucrats to influence the design of regulations, or to be exempted of compliance with them, or to free ride on public goods. Democratic control constraints rulers and bureaucrats to take care of citizens needs. Second, societies being diverse and issues being complex, it is complex and costly for decision makers, even benevolent, to identify issues and design solutions. Democratic participation is a way to guarantee more efficient and systematic identification of issues and of the means to fix them.

One polar example would be Brazil, which, despite record inequalities in income and wealth, tend to be an open-access economy and democracy; since the public debate is well developed (especially at the sub-national debate). The opposite example would then be China, which has comparable characteristic on the economic front though opposite ones on the political arena. This most clearly affect how issues like poverty, education or environment are being addressed, both by citizens and rulers. The limitation of democratic voicing in China — which his however balanced by the de-facto federal nature of the country — request stronger growth to sustain the process of development and guarantee the constitutional pact, than in countries were voicing is more open, and therefore legitimacy of the rulers more strongly established, leading the process of development to be more sustainable, both environmentally and socially.

## **6. Conclusion:**

This paper explores the inter-relationship between state construction and economic development in a long-run perspective. We propose a framework for analyzing the long-term evolution of political orders in terms of delegation received from, or withdrawn by, individual actors to their rulers. To establish and enforce rules to ad hoc governing entities. We highlight however that agents contrast two types of delegation: weak and strong. Weak delegation consist in granting a limited and targeted authority to a ruler to solve a specific set of coordination problems, for instance related to trade or to the production of local or sectoral public goods. Strong delegation corresponds to an extended delegation of power aimed at providing the ruler with an ability to establish the fundamental rights of individuals as well as the basic rules of social exchange in a given society. The issue is that once endowed with considerable power, rulers may trample on the individual and property rights of agents. This leads us to contrast two types of state that corresponds to North, Wallis and Weingast’s natural and open-access states. In some cases, the governed are able to establish strong guarantees in their relationship with the rulers. The recognition of extended and equal fundamental rights to all, combined with balance of power in the organization of the relationship among authorities bound the capability of capture of the rulers, who also have

incentives to please the governed by efficiently providing them with the public good they need in order to ensure their maintaining in their position of leadership. To the opposite, when these strong guarantees cannot be obtained from the rulers, the most powerful among them are likely to bargain with different groups in the society to guarantee them with rights, but with unequal rights since the design of asymmetric rights result in a capability of self-enforcement of a coalition in which various individual and groups get rents. In such a context, qualified in our framework as despotic constitution, the governed being unable to credibly balance the power of those benefiting from a constitutional delegation, they grant weak delegations to several rulers in charge of different dimensions of collective coordination. This way of challenging the power of rulers allows to limit capture, but result in inefficiencies (due in particular to lack of coordination) in the provision of collective coordination means and public goods. Not only it is likely that many public goods are not produced at the right scale, not only a lack of coordination among ruling entities can occur, but also there is a competition among them that bound their capability to efficiently provide these goods. When it comes to security of property rights, it is clear that conflicts among various public and private authorities can even result in violence.

Starting from this, we show that there is an intrinsic dynamic of constitutionalization processes by which citizens that might be granted unequal fundamental rights at a given historical step call for an extension and equalization of their rights, leading to the emergence of liberal orders characterized by strong equality in rights and, as a consequence, open competition among citizens. Indeed more liberal constitutions promote economic development, political freedom and participation. The main driver of this evolution is the “call” of governed for adjusting existing constitutional arrangements, so that they can benefit from more capabilities and therefore more wealth and autonomy. The essential inhibitor is the wish of elites to preserve the rents they get and share in a despotic regime that characterize natural state. There are however divergence of interest within national elite and among nations, which open space for agreements between rulers and governed, the former getting political support and increased revenues from tax thanks to the devolution of more rights to (some groups of) citizens.

Indeed, despotic regimes/natural states result in a fragmented legal order, where the potential for political and market integration will then be limited, so that the individual and collective benefits of division of labor is bounded. Liberal regimes, on the other hand, allow the construction of a coherent, integrated hierarchy of norms and jurisdictions. An integrated market combined with the freedom to organize allow to optimize division of labor, while the provision of a great number of public goods can be decentralized and therefore ensured at the optimal scale.

On the basis of these developments, we think it possible to map the standard development scenarios now observed in the world. First, failed liberal reforms would reflect either weakly established property rights or a rentier economy, where the public/ private dynamics of constitutionalization offers limited potential on an ex ante basis. Thereafter, because liberal regimes are founded on rights, and on a high degree of formalization in the social division of labor, the rules that govern economic and political competition would to some extent tame or redress the adverse impact of, say, high inequalities or oligarchic structures. Because the pours or the middle-class wage earner have access to voice, and because they can leverage opposable rights, the rulers will have to include them in the General interest, rather than remaining under the sole pressure of the richer, or the insiders. Market integration, political participation and the increase in the supply of public goods may then open on a “legitimacy-and-growth loop”, comparable to what was observed in Europe over the course of the 19th century. Critically, this seems to represent the threshold point which the most successful

emerging countries are now reaching: think to Brazil, Mexico and Chile in Latin America, Central Europe, and countries like South Korea and Taiwan.

Yet, a full constitutionalization, that would include Hobbesian rights, open access and well-governed commonalities, is not fuelled solely by political participation and economic growth. It also requires that state organizations acquire the legitimacy, the fiscal resources and the competencies needed in order to respond efficiently to the demands of new public policies. Again, addressing high poverty without ruining the public finance and creating adverse incentive is not easy. Neither is the extension of a viable network of secondary schools and universities (as Korea did). Nor is it necessary easy, even under the best laws and constitutions, to develop a supportive environment for PPP project, a working, retail level civil judiciary, or local public administration. This, in other words, is a specific type of investment; because the public goods they deliver have a quite specific function. It took fifteen or twenty years to build competent, meritocratic Central banks. Extending this success to other sectors of the public administration will be the coming stake for developing countries.

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