

Explaining institutional change: on the interplay between internal and external institutions.

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Abstract:

There is growing evidence that institutions matter for economic growth. If good institutions can spur growth, then trying to change formal or external institutions accordingly almost seems to suggest itself. Yet, external institutions will only provoke the desired effect if they are effectively enforced. It is argued that the effectiveness of external institutions critically hinges on complementary internal institutions that help citizens to overcome the problem of collective action. Assuming that internal institutions are rather stable, it is argued that societies have a fairly restricted area within which they can implement growth-enducing institutional change.

JEL classification: K 10, O 1, H 4

Key Words: Institutional Change, Effective constitution, Internal Institutions, Ideologies, Collective Action, Constitutional Economics, Economic Growth

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These three great causes serve, no doubt to regulate and direct American democracy; but if they were to be classed in their proper order, I should say that physical circumstances are less efficient than the laws, and the laws infinitely less so than the customs of the people. I am convinced that the most advantageous situation and the best possible laws cannot maintain a constitution in spite of the customs of a country; while the latter may turn to some advantage the most unfavorable positions and the worst laws.
De Tocqueville, Democracy in America, vol. I, Chapter XVII.

1 Introduction

There is growing evidence that “institutions really matter” for economic growth and development. It is, therefore, tempting to propose institutional change that would induce additional growth into economies that have been lagging behind. Often, constitutions are more difficult to change than ordinary legislation why it should make even more sense to change constitutions accordingly. It has frequently been pointed out that such institutional change is often not in the interest of the powerful with the result that it does not take place.

This paper makes a different point: It assumes that change in formal institutions will only have beneficial effects on economic outcomes if the changed institutions are factually enforced. And it argues that factual enforcement of external institutions is also (but not exclusively) determined by internal institutions that are often exempt from attempts to change them deliberately. This implies that the scope within which societies can deliberately choose to coordinate on another equilibrium than the currently attained one might be severely restricted. It also implies that there is not one single universal set of institutions that would be optimal for any country but that the optimally enforceable set of institutions depends on the concrete environment in which it is supposed to facilitate coordination.

The rest of the paper is organized as follows: In section two, our key terms are defined. In section 3, a simple game-theoretic model is introduced. The fourth section shows that the effective enforceability of constitutional provisions depends upon the prevalent internal institutions of society. Section 5 discusses possibilities to take the hypotheses developed in this paper to an empirical test. Section 6 concludes.

2 Defining Institutions and Institutional Change

Before institutional change can be defined, it is necessary to define institutions. We put particular emphasis on the distinction between state enforced institutions (“external institutions”) and those not enforced by the state (“internal institutions”) as our central

hypothesis posits that the enforceability of external institutions is a function of the valid internal institutions.

Institutions are here defined as rules or norms that are subject to an enforcement mechanism.¹ We further propose to classify institutions with regard to the kind of enforcement mechanism used. Institutions backed by the coercive monopoly of the state are called external institutions and institutions relying on private enforcement, or enforcement internal to society, are called internal institutions. It almost seems to suggest itself to also classify the constitutional provisions as external institutions but if the constitution is conceptualized as constituting the state - as done by contractarians - it cannot be an external institution itself. This classification thus leads directly into the contractarian puzzle that has been the starting point for alternative conceptualizations of the constitution within constitutional economics.² Any state that produces a minimum amount of public goods can be said to have a *de facto* constitution. This is, however, not to be equated with having a constitution in the sense of constitutionalism which is concerned with limited government and thus with constraining government action to certain areas and restricting the means government can use. Societies in which their respective governments remain within the limits laid down in the constitution will be said to have at their disposal an effective constitution, or, in other words a situation in which a society's *de jure* and *de facto* constitutions converge.³

Internal institutions can - but need not - arise spontaneously. It is possible to distinguish various types of internal institutions depending on the way noncompliance of the rule-part is sanctioned: If it is the structure of the game that ensures compliance, we usually talk of conventions. If it is the upbringing of the actor that has led him or her to internalize certain modes of behavior, the sanctioning can be thought of as occurring within the actor himself causing psychological costs in case of non-compliance. It is further possible to think of informal sanctioning done by third parties which can range from an evil eye over refusal to

¹ Following Elinor Ostrom (1986, 5), rules "... refer to prescriptions commonly known and used by a set of participants to order repetitive, interdependent relationships. Prescriptions refer to which actions (or states of the world) are *required*, *prohibited*, or *permitted*. Rules are the result of implicit or explicit efforts by a set of individuals to achieve order and predictability within defined situations ..."

² For a survey of the various conceptions, see Voigt (2008).

³ Aoki (2007) describes two different approaches to conceptualize institutions and then goes on to reconcile them. The first approach treats institutions as rules in a hierarchical order. According to the argument developed here, it would not be the constitution which is at the top of the hierarchy but rather some internal institutions. Later on, it will become apparent that internal institutions are subject to change too. In other words: our argument cannot be subsumed as belonging to the hierarchical order approach described by Aoki.

enter into further dealings to outright ostracism from the entire group. All these institutions can arise in an unplanned, i.e. spontaneous fashion. A last type of internal institution is to be distinguished from the ones hitherto mentioned: Here, an organization is responsible for the sanctioning, i.e., there is a third party that is to sanction the rule-breaker formally. Private arbitration courts are a case in point (see table 1).

Table 1: Types of Institutions

Kind of Rule	Kind of Enforcement	Type of Institution
1. Convention	Self-enforcing	Type-1-internal
2. Social norm	Self-commitment of the actor	Type-2-internal
3. Social norm	Via informal societal control	Type-3-internal
4. Private rule	Organized private enforcement	Type-4-internal
5. State Law	Organized state enforcement	External

In our argument developed below, other concepts such as ideologies, values, norms, beliefs and the like play a role. We therefore try to relate them to the definition of institutions just introduced. Depending on whether renegeing is sanctioned within one person or informally by others, traditions and customs can be classified as internal institutions of types 2 or 3. Values have been defined as "... conceptions of the desirable, influencing selective behavior" (International Encyclopedia of the Social Sciences, entry values). Strictly speaking, they belong neither to the preferences nor the restrictions within economic models but are rather to be located on a meta-level which informs the actor of how she should order her preferences - and choose, i.e. behave, subsequently (for a similar delineation, see Kuran 1998). Shared values imply shared conceptions of the desirable. In order to share conceptions of the desirable, i.e. of the 'ought', the group that is sharing those conceptions must have achieved some shared perception of the 'is' as well (see Voigt 1993, 498). The close connection to the beliefs held by the actors on how the world functions becomes immediately apparent. Questions having to do with human cognition loom large. Although some economists have stressed its importance (e.g. Hayek 1952/1976 or North 2005), our solid knowledge remains negligible.

Norms for conduct are sometimes differentiated from values: "Values are not the same as norms for conduct. ... Values are standards of desirability that are more nearly independent of specific situations. The same value may be a point of reference for a great many specific norms; a particular norm may represent the simultaneous application of several separable values" (International Encyclopedia of the Social Sciences, entry values). In economics,

incorporating norms into the models most likely means that they enter as restrictions to individual behavior. As already indicated, norms can be internal institutions of types 2 and 3 depending on how they are enforced.

Trust is a consequence of beliefs /expectations of what the person I am interacting with will do in a specific situation. To the degree that trusting somebody else is rational, it can be considered as a consequence of the contents of internal and external institutions as well as the stringency with which they are enforced.⁴

Institutions enable interacting agents to form expectations on what the other side will do or what the other side will not do. They thus reduce uncertainty and are potentially welfare-enhancing. But not any set of institutions that reduces uncertainty is automatically welfare-enhancing: internal institutions might restrict the goods that can be traded, the persons one can trade with, places and times of trade etc.. Sugden (1986) shows that conventions, i.e., one type of spontaneously arisen internal institutions, can survive even if they are not Pareto-optimal. For the rest of this paper, we will assume that spontaneously arisen internal institutions are - compared to external institutions - relatively stable. Whereas external institutions can be changed via the formal collective choice procedure, internal institutions are largely exempt from deliberate modification.

Kiwit and Voigt (1995) not only introduced this taxonomy but also dwelled upon possible relationships between the various kinds of institutions. They distinguish between four logical possibilities:

1. External and internal institutions can be characterized by a **neutral** relationship, if they deal with non-overlapping areas of human behaviour.
2. External and internal institutions can **complement** each other if they structure human behaviour in a similar fashion and rule compliance is monitored by both the state and private actors.
3. External and internale institutions can **substitute** each other if they structure human behaviour in a similar fashion but rule compliance is monitored only by either the state or private actors.

⁴ Trust can, hence, not only be the exogenous variable that determines a person's propensity to cooperate with others but is also an endogenous variable which is determined by the experiences a person has made with other persons (be they private or acting on behalf of government).

4. External and internal institutions can be **conflicting** if compliance with an internal (external) institutions necessarily implies non-compliance with an external (internal) institution.⁵

We are here interested in the conditions under which formally changed external institutions have a high chance of being factually enforced. The central hypothesis is that a complementary relationship will make the enforcement of factually changed external institutions more likely whereas a conflicting relationship will make enforcement less likely.

Given our definition of institutions, institutional change comprises (1) the transition from a state in which no formal rules exist that structure a recurrent interaction situation to a state in which formal rules exist as well as (2) the change of an existing institution to a different one. Given our definition of institutions, institutional change might also refer to changes in the sanction or the sanctionor (e.g. from private and spontaneous enforcement to state enforcement). Here, we are, however, only interested in institutional change that involves either complementary or conflicting relationships between internal and external institutions and changes in the sanction or sanctionor will, hence, not be dealt with any more.

3 Specifying the Central Hypothesis

Suppose a society in Africa attributes the well-being as well as the political stability of some European society to its constitution and decides to copy it, hoping, of course, that it will be equally well off before long. The central hypothesis of this paper is: in order to become effective, the constitutional rules chosen by this society need to be compatible with its internal institutions. If they are not, the society risks to have a constitution that is nothing more than dead letter rather soon. For our African society that would supposedly mean to gain neither economic wealth nor political stability.⁶ In this section, we inquire into possible interdependencies between internal institutions and the degree to which a society's constitution becomes effective. We do not claim that the enforceability of a constitution depends exclusively on adequate internal institutions. But we conjecture that the opposite claim according to which a society can rationally choose - and subsequently enforce - pretty

⁵ In the meantime, similar taxonomies have been developed by others (e.g. Helmke and Levitsky 2004).

⁶ One could even argue that non-enforced institutions do not only have no positive effects but might even have some negative effects: if external institutions are perceived as promises of the state which are then not enforced (i.e. broken), then trust in government will certainly suffer. This might lead to attempts to circumvent the state altogether (conducting activities via black markets, not paying any taxes, drawing on alternative dispute resolution instead of state courts and so forth) which can have negative effects.

much any constitution that some majority deems to be desirable at a certain point in time is equally mistaken. In other words, we are interested in identifying the leeway that a society whose members have an interest in an effective constitution has in coordinating on equilibria that are different from those that would have been reached did a constitution not exist at all.

Preconditions for Effective Constitutions

What are the preconditions that need to be satisfied so that we can expect a rule-of-law constitution to channel the behavior of the governing and produce wealth and stability? Coined in economic terms, one needs to insure that nobody can make himself better off by renegeing the rules laid down in the constitution. In the following, we want to focus on the behavior of the governing, i.e. those who have some discretion in interpreting the constitution. Their behavior could be constrained by other politicians, by voters, by the media, by spontaneously forming opposition etc.

Suppose a constitution formally compatible with the rule of law has been established but a large majority of the population believes that government does not comply with the restrictions laid down in the constitution. The population will only be able to stop the governing if it is able to make renegeing the constitutional constraints costly for the governing. This will most likely depend on the capacity of the population to act collectively in order to produce the public good opposition. It has been argued (Hardin 1989, Ordeshook 1992, Weingast 1995) that the constitution can be interpreted as a device which helps citizens to police state behavior. It creates focal points and helps citizens to identify when the government has remained within constitutional constraints and when it has not. The ability to monitor government behaviour is a necessary but not a sufficient condition for actually opposing the government. Opposing government is costly and opposition is furthermore a public good. Therefore, it must be demonstrated that it can be rational to voluntarily participate in the production of the public good "opposition". It is argued that a constitution will only be enforced effectively if government is confronted with a credible threat by a sufficiently large number of citizens in case it tries to cross the constraints of the constitution.

A Simple Model

Suppose society consists of only three actors of whom one has a comparative advantage in violence and constitutes government. The other two actors are players 1 and 2, respectively. Still, in order to remain in power, the government needs a certain amount of support. We assume that it remains in power as long as only one - or neither - of the other two actors opposes it.⁷ Further suppose that until now, government was not constrained by a formal

⁷ This 3-person-game draws heavily on Weingast (1995).

constitution and call this the *status quo* (SQ). The society now considers passing one of the following two constitutional rules: Rule 1 (R_1) would reduce government action to a minimum, say the protection of the subjects against external aggression and the safeguarding of order internally. But it would exclude any possibility at redistribution. Rule 2 (R_2) would give the government the capacity to redistribute wealth in addition to the tasks of Rule 1.

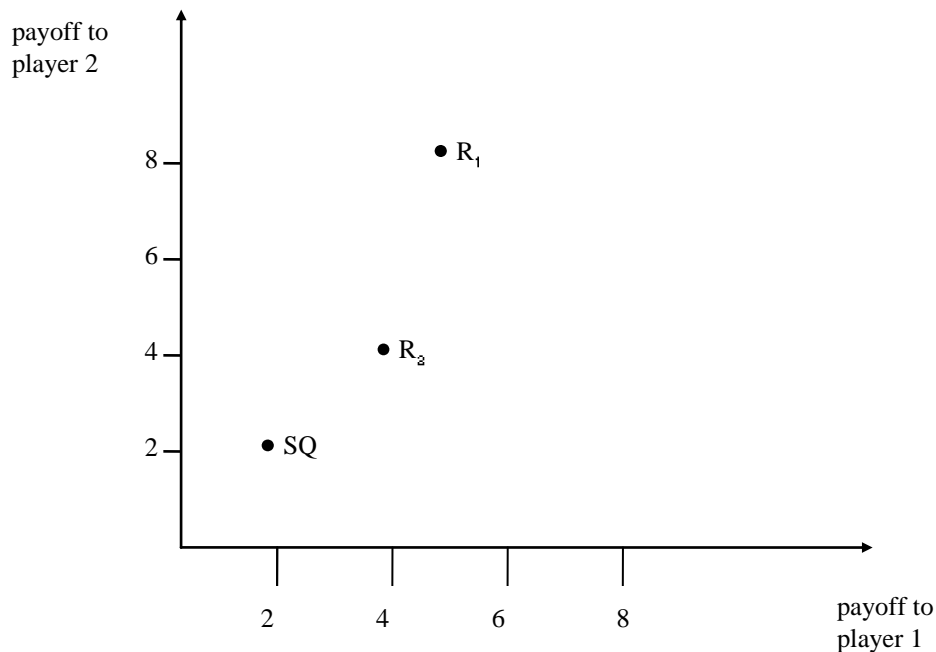
Assume for simplicity that government utility solely depends on the degree of discretion it enjoys. Government (G) orders the states of the world as indicated in (1) (a) below; one way to represent this as cardinal payoffs is given as (1) (b):

$$(1) \quad (a) \quad SQ > R_2 > R_1 > \text{Overthrow}$$

$$(b) \quad (6) > (4) > (2) > (0).$$

As already indicated, we assume that in case the two individuals are successful in jointly producing the public good opposition, the government will be overthrown which means no power, no discretion, and therefore no utility.⁸

Let us assume that an effectively implemented R_1 would lead to a higher gross national product than an effectively implemented R_2 . But let us also assume that the distribution of income depends on which constitution is chosen. Suppose, e.g., the following:



⁸ Technically speaking, we are thus dealing with a threshold public good that is only provided given a certain minimum participation in contributions to its provision.

Figure 1: Gross payoffs resulting from the introduction and effective enforcement of alternative constitutional rules

In general, one would argue that welfare would be maximized if R_1 was implemented.⁹ We now have to ask whether an effectively enforced R_1 as well as an effectively enforced R_2 are possible equilibria of the 3-person-game or only theoretically possible options that are not on the equilibrium path. To do so, we have to analyze the incentives of the participating actors in the various possible situations. Put simply: Since the government prefers the Status Quo over R_2 over R_1 , we will have to check whether the probability that the actors both oppose government varies depending on which constitutional rule is passed. We thus ask whether government has a better chance to get away with renegeing upon the constitution depending on whether R_1 or R_2 is society's *de jure* constitution.

If a player opposes government, this is connected with a cost c ($c > 0$) which is assumed to be equal for both players. If opposition is successful, we assume that the original payoff connected with the relevant constitutional regime minus c results, i.e. we assume that a new government will stick to the rules but the cost of opposition is sunk. If government reneges upon the constitution, the players receive their status quo payoffs. Player 1's preference order (a) and payoffs (b) are:

(2) (a) $(R_1) > (R_2) > (\text{successful opp. } R_1) > (\text{successful opp. } R_2) > (\text{gvmnt. reneges, not oppose}) > (\text{gvmnt. reneges, unsuccessful opp.})$

(b) $(5) > (4) > (5 - c_1) > (4 - c_1) > (2) > (2 - c_1)$.

For Player 2, the following inequations result:

(3) (a) $(R_1) > (\text{successful opp. } R_1) > (R_2) > (\text{successful opp. } R_2) > (\text{gvmnt. reneges, not oppose}) > (\text{gvmnt. reneges, unsuccessful opp.})$

(b) $(8) > (8 - c_2) > (4) > (4 - c_2) > (2) > (2 - c_2)$.¹⁰

For the time being, we thus assume that utility is uniquely derived from monetary payoffs and that they translate directly into utility. At the moment, we abstract from interdependent utility-

⁹ Of course, I do not want to deny that redistribution may be welfare-enhancing in some cases. This example is primarily concerned with the enforceability of alternative rules and not with the potential productivity of redistribution. An effectively enforced R_1 would yield higher monetary payoffs for both players (but not for G). I have chosen these payoffs in order not to have a distributional conflict between 1 and 2 since the conflict we are interested in is that between the actors 1 and 2 on the one side and G on the other.

¹⁰ For both inequations we assume that $1 < c_2 < 2$.

functions or meddlesome preferences à la Sen (1970). Suppose that government moves first and the other two individuals react simultaneously. Further assume that government can only choose between two strategies, namely reneging or not reneging the respective constitutional rule. In this three-person game, individual 1 chooses rows, individual 2 columns, and the government matrices (the payoffs are given in the order government, individual 1, and individual 2). On still an earlier level, society chooses whether it wants to play within matrix 1 or 2.¹¹ The action trees of the games look as follows:

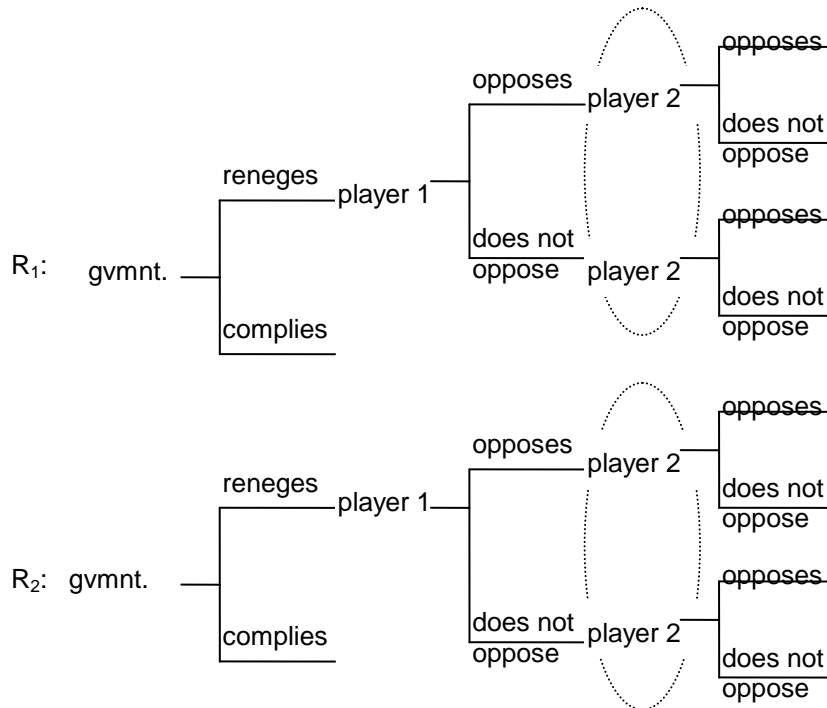


Figure 2: Action Trees of the Games

Concerning the origin of R₁ and R₂, simply assume that both have been successfully applied elsewhere and that foreign advisors are proposing them. Government can have an incentive to formally pass them if foreign aid is contingent upon having passed a constitution formally compatible with the rule of law.

If constitutional rule R₁ is passed and government delivers according to it, matrix 1a holds, if it does not comply with that rule, matrix 1b holds:

	oppose	not oppose
oppose	0, (5-c ₁), (8-c ₁)	2, (5-c ₁), 8
not oppose	2, 5, (8-c ₁)	2, 5, 8

¹¹ How this choice is brought about is not subject of this paper. There is thus no connection between the upper and the lower action tree.

Matrix 1a

	oppose	not oppose
oppose	0, (5-c ₁), (8-c ₂)	6, (2-c ₁), 2
not oppose	6, 2, (2-c ₂)	6, 2, 2

Matrix 1b

If constitutional rule R_2 is passed and government delivers according to it, matrix 2a holds, if it does not comply with that rule, matrix 2b holds:

	oppose	not oppose
oppose	0, (4-c ₁), (4-c ₂)	4, (4-c ₁), 4
not oppose	4, 4, (4-c ₂)	4, 4, 4

Matrix 2a

	oppose	not oppose
oppose	0, (4-c ₁), (4-c ₂)	6, (2-c ₁), 2
not oppose	6, 2, (2-c ₂)	6, 2, 2

Matrix 2b

Game theory has difficulties in predicting one particular equilibrium as the outcome of the game.¹² In case government does not stick to R_1 (R_2), two Nash equilibria in pure strategies of these simultaneous games attain: either (*oppose, oppose*) or (*not oppose, not oppose*). There is also a Nash equilibrium in mixed strategies for each rule: $(c/6, c/3)$ for R_1 and $(c/2, c/2)$ for R_2 which will, however, not be analyzed any further here. The government will then have to come up with probability estimates in order to choose between matrix 1a and 1b (2a and 2b).¹³ If the probability that players 1 and 2 choose to oppose G was independent of the constitutional rule passed,¹⁴ chances that R_2 was enforced would be a lot higher than chances that R_1 was enforced. This is so because successfully reneging R_1 would make G a lot better off than successfully reneging R_2 .

A second factor on which outcomes will crucially depend is the cost of opposition. To see this, we simply ask how high the cost of opposition can maximally be so that joint opposition states a possible equilibrium. To identify the appropriate cost space we simply take a look at

¹² Although some game theorists would argue that both players tend to play (oppose) if the government reneges, no matter what the *de jure*-rule based on the criterion of Pareto-dominance

¹³ In case R_1 has been passed as the constitution, G's expected utility from reneging must be at least equal to 2. This will be the case if both players' probability to oppose is $p \leq \sqrt{2}/3$. In case R_2 has been passed as the constitution, G's expected utility from reneging must be at least equal to 4. This will be the case if both players' probability to oppose is $p \leq \sqrt{1}/3$.

¹⁴ In section 4 it will, of course, be argued that this is an inadequate assumption.

matrix 1b and 2b respectively. Under R_1 the inequations $5-c \geq 2$ and $8-c \geq 2$ must jointly hold for any player's belief about the other's probability of opposing, resulting in $c \leq 3$. For any c above this threshold the opposition equilibrium is impossible. Under R_2 it must be $c \leq 2$.

Furthermore, it is important to consider how likely joint opposition is. In order to make an assessment, we have to identify under what conditions player 1 (2) will oppose G given both the cost of opposition and her belief about the probability p_2 (p_1) of player 2 (1) opposing G as well. In case R_1 has been passed as the constitution and G does not comply with it, player 1 can secure a payoff of 2 with certainty (namely by not opposing). It will thus only be attractive to oppose if the expected utility thereof is at least 2. This will be the case if the inequation

$$(4) \quad 3p_2 - c_1 \geq 0 \Leftrightarrow p_2 \geq c_1/3$$

holds. To make opposition worthwhile under R_2 , the respective inequality is

$$(5) \quad 2p_2 - c_1 \geq 0 \Leftrightarrow p_2 \geq c_1/2.$$

Given the cost of opposition and player 1's belief about the probability of player 2 opposing, player 1's opposition is more likely under R_1 than under R_2 . The same is true for player 2.¹⁵ Since this holds for both players joint opposition to G reneging is more likely under R_1 than under R_2 . According to this result, G will more likely renege upon R_2 than upon R_1 .

In case the game is repeated for an infinite number of times, the Folk-theorem holds and an even larger number of outcomes becomes possible. Game theory still lacks a commonly agreed upon equilibrium selection theory. In the next section, we want to hint at some factors that might be relevant for the equilibria chosen by the respective actors.

4 Factors Possibly Influencing Effectively Enforceable Rules

In this section, it is argued that ideologies and internal institutions can heavily influence the constitutional rules a society is able to enforce effectively. Formulated in game theoretic terms, ideologies and internal institutions serve as equilibrium selection devices. Two paths are pursued: the first is concerned with factors not reflected in the matrices that might possibly be relevant, the second path considers possible reasons for somewhat modifying the matrices and thereby reducing the number of effectively enforceable constitutions.

¹⁵ The respective inequalities for player 2 are:

$$(6) \quad 6p_1 - c_2 \geq 0 \Leftrightarrow p_1 \geq c_2/6 \text{ and}$$

$$(7) \quad 2p_1 - c_2 \geq 0 \Leftrightarrow p_1 \geq c_2/2.$$

4.1 Ideologies

(a) Individualist Beliefs

Game theory implicitly assumes that all endeavors entered into jointly by the actors serve the sole purpose of increasing individual utility no matter whether the issue be founding a company or the state. But this assumption might lead to grossly misleading predictions: If relevant parts of the population believe that fate is responsible for their lot, and not - at least to some degree - their individual actions, no relevant opposition can be expected when autocrats try to seize power and try to rule arbitrarily. The autocrat's seizure of power will then be interpreted as fate and the production of opposition as pointless. If most everybody believes individual action to be pointless, it will, indeed, be pointless. In that sense, beliefs influence the selection of an equilibrium in a game with multiple equilibria.

Moreover, if decisive parts of the population believe in organicist state conceptions that view the state as having a purpose that goes beyond the provision of public goods demanded by individual members of society, any constitution formally compatible with the rule of law will be difficult to maintain, since it would not make sense to bind the representatives of the state to the same rules that the other members of society are bound to because the representatives of the state are seen as pursuing other, "higher" ends and thus need adequate means. If large parts of the population think of the state as an organization that is responsible for identifying some "truth", it is, at least *ex ante*, by no means certain that every individual should be treated equally. In such a situation, it seems unlikely that members of a society sharing a certain organicist state conception would try to establish the rule of law in the first place. This is, however, conceivable if foreign organizations make their support conditional on constitutional rules formally in accordance with the rule of law.¹⁶

(b) The Concept of the Constitution

Another aspect of ideology which will influence the degree to which a constitution will become effective is the concept of the constitution that relevant parts of the population hold. If one distinguishes between only two such views, namely the view of the constitution as a document to be legally enforced on the one hand or the constitution as a "book of hopes" that

¹⁶ The work of Avner Greif (e.g. 1997) focuses on the effects that cultural beliefs can have on actual behavior, on values, social structure, and choice of organizational set-up. With regard to our topic, a subset of cultural beliefs, namely behavioral beliefs are of special relevance. He defines them as (ibid., 239) "... the expectations that members of the society have with respect to actions that will be taken off the path of play, and these expectations, as a cultural element, are common knowledge." He also uses the division of societies into individualist and collectivist that underlies our argument.

does not bear any direct implications on the relationship of the state with the population on the other, chances that it will be actually enforced will supposedly be higher in the first case. Positive rights such as the right to paid work, the right to adequate housing etc. are usually interpreted to be expressions of unenforceable *desiderata*. Incorporating them into the constitution should therefore strengthen the "book of hopes" view of the constitution and reduce the chances of its becoming effective. This last argument is not restricted to pre-constitutional factors anymore but does take the contents of the constitution into account. If accepted, the argument would mean that the direction of causality is not unidirectional but that we are dealing with interdependencies in the sense that the contents of the constitution can also influence the concept of the constitution that large parts of society hold.

(c) Trust

Trust has been shown to be positively correlated with economic growth (Zak and Knack 2001). This seems straightforward since people who trust each other will have to spend less on monitoring their interaction partners, i.e. they can save on transaction costs. It is conjectured here that this does not only hold for traditional market transactions, but also (a) for interactions between government and the population at large, (b) for interactions between competing politicians, and (c) for interactions between diverse actors within the population *vis-à-vis* government. If one reduces the games introduced above to the subgames in which the two members of society must decide whether or not to oppose government, the resulting games are structurally equivalent to the stag hunt game usually attributed to Jean-Jacques Rousseau (1754).

	oppose	not oppose
Oppose	$(5-c_1), (8-c_1)$	$(2-c_1), 2$
not oppose	$2, (2-c_1)$	$2, 2$

Modified matrix 1b (payoffs denote those of player 1 and player 2 respectively).

	oppose	not oppose
Oppose	$(4-c_1), (4-c_1)$	$(2-c_1), 2$
not oppose	$2, (2-c_1)$	$2, 2$

Modified matrix 1b (payoffs denote those of player 1 and player 2 respectively).

Given that c is sufficiently low, it is often argued that the players should be able to coordinate their behavior on *(oppose, oppose)* under both rules. Binmore (1994, 120-4; 1998, 349) is not that optimistic. He calls the NW-equilibrium payoff-dominant and the SE-equilibrium risk-dominant. Of course, one could ask what incentives players should have not to coordinate on *(oppose, oppose)* if they have the chance to communicate. Whether they will depends on the amount of trust they have developed for each other. Since we assume the status quo to be a state in which government is not effectively restricted at all, we know that the players haven't been able to coordinate on *(oppose, oppose)* in the past.

Trust cannot only be conceptualized as an "extra" constitutional factor which somehow influences the probability of a constitution being enforced. "Trust" can also be conceptualized as reflecting the experiences of the population with government. If the population trusts government, one can conjecture that government must have acted in accord with the population's expectations, if it does not, government might have acted contrary to them. In other words, trust can also be conceptualized as the dependent, and not only as the independent variable. This surely leads to methodological problems and is taken up later.

4.2 Internal Institutions

(a) Norms

Pointing to individualist beliefs mainly served to make us aware of an important implicit assumption of game theory. But given that individualist beliefs are present, we would still not be able to discriminate between R_1 and R_2 concerning their respective enforceability. Let us therefore turn to internal institutions and more specifically to norms backed by more general values.

Suppose that an individual feels better if she complies with the valid norms of her society. Her utility-function now has two components: the monetary payoff she receives under a constitutional rule and the satisfaction she derives from behaving in accordance with the valid norms. The introduction of a second argument influencing utility might appear *ad hoc* and thus little convincing. In order to be meaningful, the propensity to value cooperation *per se* has to be ascertained independently of the specific game under consideration. By now, there is convincing evidence that values and norms do channel behavior and thus social outcomes in a multitude of interaction situations (Voigt and Kiwit 1998 is a survey; Ben-Ner and Putterman 1998 have assembled many of the important contributors).¹⁷

Suppose a society shares a value of social equality which focuses primarily on equality of results and that it has developed some norms of solidarity that channel behavior in ways compatible with advancing that value. It might then be the case that individual 1 will not oppose government in case it reneges upon R_1 (because the constitution is not conducive to its conception of equality) whereas it will oppose government in case it tries to renege upon R_2 (because that constitution is, if enforced, conducive to its conception of equality). Let us call

¹⁷ Of course, values and norms are not exogenously given and their emergence can be explained drawing on the tools of economics. Values and norms can be interpreted as rational answers to some interaction problems. The studies that focus on their change teach us that they can persevere although the problems that originally caused their first-time emergence have long dissolved (see e.g. Sugden 1986).

the additional satisfaction from norm-following its "reward" which will be denoted by "r". In terms of payoffs, these values-cum-norms could lead to the following modifications:

	oppose	not oppose
oppose	0, (5-c ₁), (8-c ₂)	3, (2-c ₁), 2
not oppose	6, 2, (2-c ₂)	6, 2, 2

(Unmodified) matrix 1b

	oppose	not oppose
oppose	0, (4-c ₁ +r), (4-c ₂)	6, (2-c ₁ +r), 2
Not oppose	6, 2, (2-c ₂)	6, 2, 2

Modified matrix 2b

If $r \geq c_1$, then player 1 would choose (*oppose*) no matter what player 2 does. If player 2 believes that the utility player 1 derives from norm-compliance is such that $r \geq c_1$ holds, player 2 will also choose (*oppose*) and they will be able to constrain the government effectively.¹⁸ If the government foresees this, it will choose matrix 2a and not matrix 2b. R_2 would thus have higher chances of becoming effective than R_1 .¹⁹

(b) Ability to Overcome Problem of Collective Action

A society consisting of three individuals only is very rare. Suppose society consists of $n \gg 3$ individuals. In that case, it seems more plausible to assume that it is easier for organized groups than for individuals to oppose government in case it reneges on the contents of the constitution because these groups have already solved the problem of collective action. Yet, the production of opposition remains a public good and the conditions under which it can be beneficial for an organized group to participate in its provision need to be specified.

The hypothesis that organized (interest) groups might have favorable effects runs counter to established economic wisdom: Olson (1982) argues that within stable regimes, ever more latent interest groups will manage to become manifest interest groups. Ever more interest groups will be successful in their rent seeking endeavors which will lead to stagflation, rigidities and reduced economic growth. Olson thus focuses on economic outcome variables. Political scientist Robert Putnam (1993) argues that the performance of democratic

¹⁸ From experiments we know that actors are strongly afraid of being exploited. This would mean that $r > 0$ is contingent upon the other actor also opposing government. We haven't added r for player 2 just to keep the matrix clear.

¹⁹ Essentially the same point can be made by introducing interdependent utility-functions and by assuming envy in such a way that other players' payoffs enter my own utility-function as a negative argument. In that case, the probability of player 1 contributing to the public good "opposition" will *c.p.* be lower in 1b compared to 2b. On the possible effects of envy Schoeck (1966).

institutions improves if they are backed by a large number of horizontally organized voluntary associations. Elsewhere (Voigt 1998), I have modified the Putnam-argument and applied it directly to a society's possibility to make a government stay within the confines laid down in the constitution.

The conjecture is that chances that a constitution will be effectively enforced are higher if there is a substantial number of manifest interest groups with heterogeneous interests that command a considerable threat potential. The threat potential of a group is determined by its ability and willingness to inflict costs on others and thereby reduce the net social product and the benefits ensuing to the various groups. To see this, the original model developed above needs a little modification: suppose government can improve its own utility by granting privileges, exemptions etc. to a number of groups who are willing to pay for such special treatment in return. We thus introduce the possibility that government can discriminate between actors and introduce also another source of utility for government besides discretion introduced above, namely side-payments. Privileges to one are always discriminations of others. If these others are organized as interest groups, they will oppose the privilege sought after by the first interest group. The condition that interest groups need to be heterogeneous thus means that groups which would be negatively affected by some privilege are also organized. They have an incentive to oppose the granting of certain privileges if that action is connected with a higher expected utility than the option of not opposing. In an infinitely repeated game, this could be the case if trigger-strategies have led to a norm of opposition that tells groups to oppose such government action even if they are not directly affected negatively themselves. Opposition will, however, only be successful if the opposing group(s) have at their disposal some threat potential which, if used, would reduce the net-benefit for government of granting some preferential treatment below the net-benefit of not granting preferential treatment.²⁰

Wrapping it Up

The argument developed so far thus reads: In order to keep the governing within the boundaries laid down in the constitution, the capability of producing the public good "opposition" is the best insurance. A written constitution might indeed help to specify the range of legal government action. A written constitution itself can, however, never insure that in cases in which the government attempts to make itself better off by not complying with the constitution, opposition which will restrain government will indeed emerge. It has been

²⁰ In parliamentary systems, this can be secured if legislators represent heterogeneous interests. Having to convince (or to buy) many parliamentarians can be more costly than having to buy a single autocrat (Root 1994, 157). In the limit, net benefits of rent seeking in parliamentary systems will fall to zero so that less resources will optimally be spent on it.

argued in this section of the paper that the likelihood of opposition forming - and the probability of a *de jure* constitution to become effective - depends on

- (1) beliefs,
- (2) the concept of the constitution,
- (3) the amount of trust,
- (4) moral norms, and
- (5) the capacity to act collectively.

These preconditions for effective constitutions can also be called "extra" or "pre" constitutional conditions. They largely rest on the ideologies and internal institutions prevalent in a specific society.²¹

As already spelt out in the subsection regarding a society's concept of the constitution, it is by no means certain that we are dealing with a unidirectional causal relationship in which the internal institutions are exogenous and completely stable and the constitutional provisions are completely endogenous. It is very well conceivable that - at least in the long run - constitutional provisions can have an influence on beliefs, moral norms etc. Methodologically, this is nasty because everything becomes interdependent. Substantially, this allows for the hope that more societies might be able to enforce rule of law-constitutions at least in the long run.

5 Towards an Empirical Test

Section four developed a number of factors that could determine the likelihood of a formal constitution getting factually enforced. Taking these factors to an empirical test is no mean feat for a number of reasons: (1) the factors supposedly impacting on the factual enforcement of constitutions need to be formulated as hypotheses that are, at least in principle, empirically testable; (2) in order to test the generated hypotheses empirically, proxies for both the dependent as well as the independent variable are necessary; at least two problems need to be dealt with namely (a) how to adequately disentangle broad concepts like "the constitution" and (b) how to separate *de jure* from *de facto* rules; (3) there are huge endogeneity problems:

²¹ In the last subsection, we have allowed society to consist of more than three members. But so far, we are still assuming government to consist of just one actor. Here, we cannot broaden this assumption systematically. Suffice it to point out that the number of actors within government is often significantly larger than one and that their preferences are often quite diverse. In fact, the separation of powers doctrine can be interpreted as an attempt to profit from the divergent interests of the governing and to increase the chances that constitutional constraints will be factually enforced accordingly.

in some cases causality can run in both directions. Trust could, e.g., have an impact on the factual enforcement of constitutions but the factual enforcement could, in turn, also have an impact on the amount of trust found in society; (4) the relationship between some of the explanatory variables could cause problems of multicollinearity. In this section, each of these problems will be taken up shortly.

Let us first try to push the factors assumed to influence the factual enforcement of constitutions towards testable hypotheses. The first factor was concerned with the kind of beliefs prevalent among the members of a society. Formulated as a hypothesis:

$$\begin{array}{l} \text{Factual enforcement of} \\ \text{(rule of law) constitution} \end{array} = f(\text{degree of collectivist beliefs}) \quad (8)$$

We hypothesize that there is a negative correlation between the two variables. The second factor introduced a distinction between the constitution as a legal document on the one hand and as a book of hopes or aspirations on the other. One way to proxy for this could be the number of positive rights promised to the citizens of a state: the more promises the constitution makes, the less these would indicate that the constitution is meant to be a legal document.

$$\begin{array}{l} \text{Factual enforcement of} \\ \text{(rule of law) constitution} \end{array} = f(\text{number of positive rights}) \quad (9)$$

Again, we would expect a negative coefficient. The third factor dealt with trust. It seems crucial to separate trust in one's fellow citizens from trust in government officials here. Given a high level of trust among citizens, they might be able to cooperate in the stag hunt game depicted above. Formulated as a hypothesis:

$$\begin{array}{l} \text{Factual enforcement of} \\ \text{(rule of law) constitution} \end{array} = f(\text{degree of generalized trust}) \quad (10)$$

Here, we would expect a positive coefficient. The fourth factor, namely norms of cooperation, seems particularly difficult to express in the form of a hypothesis. The argument is that constitutional rules that are in line with the informal norms held by a majority of a society's citizens will increase the likelihood of factual constitutional enforcement. This means that the explanatory variable needs to be defined as the amount of congruence or similarity between informal norms and formal constitutional rules. Since both a country's constitution and a society's norms have many dimensions, taking this hypothesis to an empirical test will be very difficult indeed. Formulated in a rather abstract way, it could read:

$$\begin{array}{l} \text{Factual enforcement of} \\ \text{(rule of law) constitution} \end{array} = f(\text{similarity formal con rules AND informal norms}) \quad (11)$$

Finally, a society's capacity to act collectively was hypothesized to be positively correlated with the factual enforcement of the constitution. It was argued that this capacity is itself a function of (a) the number of organized interest groups and (b) their diversity. One way to formulate this as a hypothesis could be:

$$\text{Factual enforcement of (rule of law) constitution} = f(\text{number of interest groups} * \text{diversity}) \quad (12)$$

The formulation chosen in equation (12) presupposes that the number of interest groups and their diversity can substitute each other. Alternative specifications could also be tested.

The second problem that needs to be dealt with before the hypotheses can be put to an empirical test are adequate data. The problem appears to be most severe with regard to the dependent variable: does it make sense to think of one overall degree of factual enforcement or is it preferable to distinguish between various areas (e.g. distinguishing between the relationship between individual citizens and the state on the one hand and the relationship between various government agencies amongst each other on the other)?²²

Endogeneity was the third problem mentioned above. It seems to be relevant with regard to all factors hypothesized to impact on the factual enforcement of constitutions. Individualist (or collectivist) beliefs are, e.g., not exogenously given but could be formed by one's experiences with a society's constitution. In order to be meaningful, the beliefs to be measured need to be ascertained independently of experiences with the factual enforcement of constitutions though. Practically, this seems, however, almost impossible to do. The possibility of reversed causality has already been mentioned with regard to trust above. This is why we turn to the capacity to act collectively, where endogeneity is also a problem. One concept of the constitution interprets it as a device that helps individuals to coordinate their behaviour by creating, or speeding up the process of creating, focal points. If this is the case, then the constitution would be one variable explaining a society's capacity to act collectively – and not the other way around.

Finally, the possibility of multicollinearity was named as the fourth problem. Given that it was possible to come up with convincing proxies for all relevant variables, possible interdependencies between some of the explanatory variables should be kept in mind. In

²² The problem does not seem as severe for the explanatory variables: for the beliefs, one could rely on Hofstede's (1997) individualism index, for the factual enforcement of positive rights anchored in the constitution on Ben-Bassat and Dahan (2008), for the level of trust, the various waves of the World Value Survey (1999) are an excellent starting point. Knack and Keefer (1997) have introduced the distinction between "Olson-groups" and "Putnan-groups" that could be an interesting starting point for finding a proxy reflecting a society's capacity to act collectively.

addition to the four problems mentioned, it is unclear how adequate cross-country regressions would be for our question. On the one hand, cross-country analysis seems the natural approach towards putting our hypotheses to an empirical test. On the other, case studies could also be useful with the caveat that the quality criteria for good case studies are even more vague than those for cross-country studies.

6 Conclusions and Outlook

In this paper, we have argued that societies do not have *carte blanche* in choosing how to choose if they are interested in having an effective constitution. They should therefore not succumb to wishful thinking because in that case, chances that constitutional rules will become effective at all appear rather slim. In section 3 of this paper, it was argued that internal institutions can be interpreted as restricting a society's leeway in the choice of its constitution. In section 4, it was assumed that internal institutions were given and it was attempted to sketch some advice on how societies could use their - limited - leeway.

In this paper, the procedures used by societies to give themselves constitutions have not been considered at all. Some authors conjecture that broad popular participation increases the likelihood of the constitution becoming effective (Ordeshook 1993, 203; Mueller 1996, chapter 14). Anecdotal evidence tells us that this does not have to be the case: The Brazilian Constitution of 1988 with its enormously long list of positive rights experienced much popular input. The question sure merits further research.

Another research topic would deal with the role of organized groups in more depth. In contractarian constitutional economics, they have not been dealt with at all; it is the atomized and unorganized rational individual that founds the state and leaves anarchy. For the maintenance and change of constitutions the relevance of organized groups can, however, hardly be exaggerated. They should therefore be integrated into economic models of the state. This leads almost automatically back to Tocqueville (with whom this paper began) because voluntary associations are at the core of his concept of Civil Society (1849/1945). His conjecture is that physical circumstances are less important than the laws and that the laws are less important than the customs. Redefining customs as internal institutions, it has been argued here that his point is still valid today.

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