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**The Impact of Administrative Power on Political and  
Economic Developments: Toward Political Economy of  
Implementation**

by  
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“Your wish is my command,” is a phrase rulers hope to hear from their administrators. Unfortunately for many rulers, administrators tend to have the irritating habit of looking out for themselves instead. The premise of this paper is that this tendency reflects that any ‘ruler’ (e.g., a dictator, elite, or elected leader) who makes policy choices must rely on an administration to *implement* them. A ruler’s administrators can therefore be in the particularly advantageous position of being able to challenge him while reducing, at the same time, his ability to retaliate.

This observation suggests a positive theory explaining different historical developments of political institutions. ‘Constitutional institutions’ – the rule of law, constitutions, and political representation – will first emerge with respect to *powerful administrators* who have the ability to impose sanctions on a ruler.<sup>1</sup> A relatively large initial endowment of powerful administrators is necessary for the rise of the constitutional state while a small initial endowment leads to absolutism.

If constitutionalism first emerged with respect powerful administrators, it could not have, as commonly asserted, led to prosperity by providing universal protection of property rights. When constitutionalism supported by administrative power, only the powerful has rights, economic institutions and policies are biased in favor of those benefitting the administrators and against those undermining their power. Prosperity is not necessarily the result. Why, then, does history reflect positive correlation between constitutionalism and prosperity?

The positive correlation between constitutionalism and prosperity reflects the impact of *administrative structure* on administrative power and incentives to create new sources of wealth. First, administrative structure influences power. Specifically, the more the administration is decentralized in the sense of being controlled by the administrators, the more power they have. Sufficiently decentralized structure, therefore, provides the administrators with the power to prevent choices undermining their power. In addition, decentralized administration fosters the rise of new economic elites. It has a comparative *dis*-advantage in controlling the non-elites and therefore better motivate them to create new source of wealth. Finally, constitutionalism

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<sup>1</sup> Institutions are self-enforcing systems of rules, beliefs, norms and their possible manifestations as organizations that generate regularities of behavior (Greif 2006). For ease of presentation, I use the verb ‘sanction’ to mean imposing economic or military coercive sanctions.

provides an institutionalized way to absorb the emerging group without military conflict. Sharing political power with them is a quantitative and not a qualitative change.

Constitutionalism and prosperity are therefore correlated as decentralized administrations are more likely to imply a ‘virtuous’ cycle of mutually reinforcing and complementary constitutional and economic expansions. Centralized administrations, in contrast, have comparative advantage in controlling the non-elite. They therefore provides non-elites with weaker incentives for the creation of new wealth. Moreover, because centralization does not imply constitutionalism, there is no institutionalized way to absorb the emerging new elite.

This paper advances this conjecture and provides anecdotal historical evidence to support it. The analysis examines the relations between administrative structures, constitutionalism and prosperity by exploring the incentives different structures provide. It suggests that administrative power is an unappreciated factor which, during the last millennium, contributed to constitutionalism and economic development in the West and to its uneven growth elsewhere.

Focusing on implementation (and hence administration) in considering institutional development differentiates this paper from the more common *choice*-theoretic approaches to institutional development. The choice-theoretic approach implicitly assumes that rulers’ choices of political institutions and economic policies correspond to outcomes and abstracts from the need to implement these choices.<sup>2</sup> While this assumption is useful in examining various issues, we can gain from combining the analysis of choice with that of the strategic problem associated with creating administration and implementing choices.

Focusing on the origin of institutions as an equilibrium in the ruler-administrators relations, differentiates this paper from four related literatures. First, the literature using agency theory to study a ruler’s choice of administrative forms.<sup>3</sup> Second, the ‘iron triangle’ literature on the interactions between politicians, bureaucrats, and interest groups (e.g., McConnell 1966) and third, the literature on the determinants of bureaucratic performance and the importance of administrative capacity in state building and development (e.g., Wilson 1991). These important

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<sup>2</sup> E.g., Bates, 1991; Bates et. al. 2002; Olson 1993; Acemoglu et. al. 2005; Acemoglu and Robinson 2006; North 1982, 1990; North and Weingast 1989; Greif 1994a; Greif 1998.

<sup>3</sup> E.g., Moe 1997; Levi 1989; Rose-Ackerman 1999; Kiser 1999; Gormley and Balla 2004; Dixit 2006; Shleifer and Vishny 1993; Mazmanian and Sabatier 1989.

lines of work have taken legal and political institutions as given, while this paper considers them as endogenous, equilibrium outcomes.<sup>4</sup> Finally, considering the strategic problem between administrators and rulers differentiates this paper from the literature examining choices of administrative structure and capacity as a function of the relations among social groups (e.g., Greif 1998) or among rulers and their subjects (e.g., Greif 2005; Arias 2007).

It is important to emphasize that the discussion here is preliminary. It neither provides an explicit model, nor conducts an empirical test or rigorously integrates important considerations such as technological changes, environmental factors, culture, or inter-state interactions. As such, it represents the beginning rather than the end of a research agenda. Its aim is only to highlight the merits of developing the political economy of implementation. Its key insight is that distinct initial endowments of administrative power can have profound implications on historical trajectories of institutional and economic developments.

The paper is structured as follows. Section I provides a synopsis of the argument and further surveys the relevant literature. Section II develops the concept and examines the equilibrium origins of administrative power – power being the measure of the administrators’ ability to sanction a ruler. Section III presents why – although effective administrations are economically beneficial in reducing violence – polities tend to experience violent and hence costly cycles between centralization and decentralization. Section IV discusses how and why administrative power leads to constitutional institutions as equilibrium outcomes and section V elaborates on the implications of constitutionalism on economic prosperity.

Section VI presents why distinct administrative structures bias the distribution of political conflicts. Section VII considers the theoretical implications of these different distributions on incentives to create new wealth, economic growth, and the development of constitutionalism (and particularly enfranchising new elites). While the discussion throughout provides anecdotal evidence, section VIII is devoted to examining distinct historical trajectories of economic and institutional developments in light of the theory developed here. The concluding comments relate this historically inspired discussion to contemporary issues.

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<sup>4</sup> Greif 2006 elaborates on the analysis of institutions-as-equilibria.

## I. Synopsis and Related Literature

This section provides a short synopsis of the argument and relates it to the literature. It is not aimed at summarizing the argument but only to presenting its main ingredients.

As already noted, a ruler ('policy maker') has to rely on an administration to implement his choices. An administration, on the other hand, can potentially implement choices without a ruler. Furthermore, administrators are in a particularly advantageous position to challenge a ruler because they are the only group that can mount such challenge while simultaneously depriving the ruler of the capacity to punish them. These two observations suggest that the interactions between rulers and their administrators are likely to shape institutional development.

Military, financial, or legal administrators have often defied a ruler and thereby influenced institutional development. The governing bodies of the Thirteen Colonies, for example, were active in the War of Independence. Clearly, administrators most of the time do not defy their rulers, but this equilibrium outcome does not indicate whether the possibility of administrative defiance impacts institutional development. Rulers, as a matter of fact, often took preventive or accommodative actions to co-opt their administrators or reduce their ability to defy them. After 1776, for example Britain was reluctant to give its colonies self-governance.

The concept of *administrative power* is developed here to express the administrators' ability to defy rulers. They have this power when they can credibly threaten to impose sanctions on a ruler if he attempts to implement a particular choice, and this threat is sufficient to deter him from making this choice. Medieval European kings often made various choices to avoid violent responses from their administrators, the feudal lords. The more choices the administrators can thereby influence, the more power they have.

Power is an endogenous outcome that depends on various environmental and technological factors. In addition, however, power depends on administrative structure. This structure is *decentralized* when the ruler has no institutionalized way to prevent his administrators from using their administrative capacity against him. The agents serving these administrators answer to them, not the ruler. The thirteenth-century Barons that demanded the Magna Carta, for example, were decentralized administrators. They had direct control over the resources of their domains and their knights were personally loyal to them, not the king. In contrast, an administration is centralized when no administrator can use his administrative capacity against

the ruler. The most the administrator can do is quit but each has a perfect substitute. An example of a centralized administration is the system under which the French kings auctioned tax farming to individuals who were perfect substitutes for each other before and after the auction.

The more decentralized an administrative structure is, the more power the administrators have. Moreover, sufficiently powerful administrators can prevent the implementation of choices to centralize the administration. An administrative structure, in this case, is self-enforcing.<sup>5</sup> Similarly, if the ruler is able to establish a *centralized* administration that is directly under his control, he can implement the choices that perpetuate this structure. Administrative structures, whether established by a ruler or inherited from history, can be self-enforcing and hence perpetuate. (Section II.) Administrative structures are inherently unstable in the sense that they are self-enforcing in a small set of parameters. They are also inherently self-undermining; they imply processes that make this set smaller. Hence violent political cycles of centralization and decentralization are likely outcomes and the associated conflicts are economically costly. The economic benefit of any effective administration is reduction in violence. (Section III.)

When administrators are powerful, the distribution of (legal, political and economic) rights between them and the ruler reflects their relative powers. Each side is deterred from transgressing the other's rights. The ruler, in particular, will avoid making choices so adverse to the (decentralized) administrators that they will respond by imposing sanctions. There is a 'limited government,' one which does not arbitrarily assign rights with respect to the administrators. In other words, the administrators join the *elite*, namely those whose preferences influence political choices. It consists of the ruler and administrators when the administration is decentralized and the ruler alone when the administration is centralized. Intra-elite relations are not only confrontational, however, because the rulers' and the administrators' preferences can be the same regarding various choices (e.g., defense).

Decentralized administration implies more than secured rights as an equilibrium outcome. In addition, powerful administration is a necessary condition for the self-enforceability of 'constitutional institutions:' constitutions, representative assemblies, due process and equality

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<sup>5</sup> Previous analyses of the impact of economic or coercive powers on the rule of law assumed that agents are endowed with this power. E.g., Olson 1993; Bates 1991; Bates et al. 2002; Barzel and Kiser 1997; Haber et al. 2003; Skaperdas 1992.

before the law. These institutions are also Pareto-optimal to the ruler and administrators and hence they are motivated to establish constitutional institutions to govern their relations.<sup>6</sup> These institutions reduce the likelihood of costly conflicts (between rulers and administrators) due to information problems. They enable a ruler to credibly signal when a decision is not aimed at shifting the balance of power in his favor. By submitting himself to a pre-determined decision-making process, the ruler reduces his discretion and therefore also the possibility of multiple interpretation of his actions. In addition, constitutions reduce the likelihood of conflict due to different understandings of who has what rights. Finally, representative assemblies provide an institutionalized means to share information and coordination on mutually beneficial choices that would not be made by the ruler unilaterally (without the consent of the administrators) due to the risk of invoking sanctions. (Section IV.)

This analysis highlights the possibility that the origin of constitutionalism is endogenous to administrative power. Legal and political institutions are not only determined by environmental conditions (e.g., Engerman and Sokoloff 1997; Rodrik et. al. 2003), technological factors (e.g., Ticci and Vindigni 2006), class conflicts (Acemoglu and Robinson 2006; Lezzeri and Persico 2004), and distinct social and cultural features (e.g., Aston and Philpin 2002; Greif 1994b; Mokyr 2006) but are also determined by administrative power.

Similarly, the analysis highlights the roles of constitutional institutions in reducing the expected costs of conflicts due to information problems. This view of institutions as ‘information machines’ complements the one of institutions as ‘commitment devices’ which considers constitutions as coordinating economic agents on an equilibrium in which the ruler respects their rights fearing multilateral sanctions.<sup>7</sup> A key difference is that the “institutions as commitment devices” view assumes that an equilibrium with secured rights exists and hence constitutionalism role is only to coordinate on it. The analysis here, in contrast, highlights the endogenous

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<sup>6</sup> Because assemblies enabled administrators to coordinate opposition to rulers, but rulers were in a position to coordinate on summoning an assembly, the latter were the binding constraints.

<sup>7</sup> E.g., Hardin 1989; Weingast 2005. This is a special case of a more general phenomenon. The threat of multilateral punishment is credible if the players share the belief that particular multilateral punishment strategies will be followed and if they some cultural or formal rules provide a uniform interpretation of what action constitutes a deviation. (Greif 1994; 2006). Fearon 2007 considered the role of elections in revealing information about governmental mis-conduct.

conditions under which such an equilibrium exists (i.e., when self-enforcing administrative structure implies power) and the role of institutions in reducing the costs associated with this equilibrium by mitigating information problems.

The conjecture that administrative power has historically underpinned legal and political institutions, has various implications regarding the relations between institutions and economic prosperity. In particular, while choosing economic institutions and policies (e.g., taxation systems or legal enforcement) rulers and administrators will consider their impact on the balance of administrative power. Prosperity-enhancing economic institutions and policies will not be chosen under constitutional institutions, for example, if this undermines the administrators' power. This simple observation seems to provide insights in understanding puzzling historical phenomena, such as why the modern market economy did not emerge in China or why pre-modern Poland, despite its constitutional institutions, failed to develop. (Section V.)

Decentralized administrations and constitutional institutions nevertheless might have been the key to economic growth and the rise of liberal democracy. Relative to centralized administrations, decentralized ones are less efficient in preventing non-elites from engaging in wealth creating activities. Therefore they provide stronger incentives to create new wealth. Political conflicts are therefore more likely to transpire between the prevailing and aspiring elites rather than among subsets of the existing elite. Centralized administrations, on the other hand, are relatively more efficient in extracting rent and controlling the non-elites. Therefore they undermine incentives for non-elite to acquire wealth. Political conflicts are more likely to be among subsets of the elite or between them and the destitute. (Section VI.)

The implications for growth and institutional development are profound. (Section VII.) Centralized administrations are more likely to lead to vicious cycles of economic stagnation and re-distributive political conflicts that further weaken incentives to create new wealth. The polity and the economy are zero sum games under a centralized administration. Decentralized administrations, in contrast, are more likely to lead to a virtuous cycle of economic and political development. Political and economic conflicts are positive sum games. Incorporating the emerging elite implies sharing a larger pie. Constitutionalism, in turn, provides a means for peaceful compromise without disenfranchising the existing elite. The prospect of economic and



political returns from creating new wealth reinforces incentives to do so. The larger the elite becomes, the lower the cost of increasing it and the more difficult it is to mount a revolt or a coup.

In reality, of course, these processes are neither deterministic nor continuous. Rulers might gain from centralizing the administration and their task is often facilitated by divisions and collective action problems among administrators. Powerful decentralized administrators might gain from secession and centralizing control in their domains. The decentralized administration has to be effective enough to prevent internal violence and external threats but relatively ineffective in preventing the non-elite from creating new wealth. Incorporating the emerging elite is facilitated if the source of their new wealth complements, rather than substitutes, that of the elite.

Historically, late medieval Europe embarked on a virtuous cycle of decentralized administrations, constitutionalism, and growth. In most states, however, this developmental trajectory ceased for various reasons. It may have prevailed, more or less continuously, in England alone. Yet, pre-modern de-centralized administrations and constitutionalism have left an administrative and cultural heritage that facilitated modern transitions to liberal democracy. The beliefs and values behind the French Estates-General (its national assembly) declaring itself a National Assembly had deep roots. (Section VIII.)

This analysis abstracts from important issues. It ignores (by and the large) the strategic interactions among administrators and abstracts from interactions among administrative structures and other factors. It excludes, for example, the impact of technological changes on administrative capacity and the beliefs the agents hold about the structure of the situation and behavior in it.<sup>8</sup> These simplifications, however, highlight the main point: there is potentially much to gain from integrating the strategic problem associated with implementation of choices in political economy.

## **II. Administrative Structure and Power**

This section defines centralized and decentralized administrations and administrative power. Under a centralized administration, any administrator can be replaced without reducing

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<sup>8</sup> Regarding the implications of such structures and beliefs on political and economic developments, see Weber 1927; North 1990, 2005; Greif 1994b, 2006, 2006a; Mokyr 2006; Jones 1989.

the ruler's administrative capacity. Under a decentralized administration, an administrator can reduce the ruler's administrative capacity by withdrawing his services. When an administrator can credibly commit to withdraw his services, he has administrative power. Power is determined by the administrative structure. The more decentralized the structure, the more powerful the administration.

### **Centralized and Decentralized Administrations**

One objective of the analysis is to understand the endogenous development of an elite, or those who have political voice and influence on political choices. Accordingly, suppose for the moment that a ruler makes choices regarding economic institutions and policy. Whether a ruler is a person (such as a king, dictator, or president) or a group (such as a tribe, party, ethnic group, oligarchy, republic, or theocracy), governing requires an administration.<sup>9</sup> An effective administration executes political choices by acting on the ruler's behalf (e.g., assembling an army or dispensing justice), making political choices publically known, monitoring behavior, and punishing deviators.

More generally, an administration influences the set of political choices that, if made, will be followed. Federal tax rates are chosen by the federal authorities, for example, but the effectiveness of the IRS determines the tax revenues that will be collected. The IRS handles the mechanics of tax collection, such as receiving payments and sanctioning those who fail to pay. Similarly, a ruler might choose to have an army of a certain size but a military administration is necessary to implement this choice. It must obtain the necessary funds (possibly from a specialized financial administration), solicit recruits, and equip, train, transport and maintain them. Feudal lords had military capacity because they controlled a military administration.

Administrations are composed of individuals and organizations that are directly involved in the implementation of military, financial, legal or other political choices (e.g., a professional or citizens' army, the IRS, feudal lords.) An administration can be characterized by the degree to which it is *centralized* or *decentralized*.

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<sup>9</sup> Administration are established for other reasons as well. They are strategically created by politicians to perpetuate their policy (e.g., McCubbins, et. al. 1987) and they respond, in modern societies to variety of factors (e.g., Wilson 1991).

An administration is centralized when it is directly under the ruler's control in the sense that actual and potential administrators are perfect substitutes (except for their personal qualities). Replacing any administrator therefore does not change the administration's value to the ruler. The bureaucracies of Imperial China and modern planned economies are examples of centralized administrations.

An administration is decentralized when it is directly under the administrators' control in the sense that potential administrators are not perfect substitutes for the incumbents. A ruler can not dismiss an administrator without losing administrative capacity. Feudal lords with taxing capacities and military organizations, elders of tribes with economic and military resources, and governors of autonomous provinces are examples of decentralized administrations. Another example is the Genoese financiers who were unmatched in their ability to pay the Spanish troops in Flanders during the Dutch Revolt.

As these examples illustrate, decentralized administrators do not necessarily control a particular territory, although this is often the case. Decentralization is a matter of who has the resources, information, organizational skill, reputation and loyalty of subordinates to effectively implement choices. When the administrators have these capacities, potential administrators cannot perfectly substitute for them. Hence, the incumbent administrators can choose whether to provide or withhold the services of the administration to the ruler. The ruler cannot replace or circumvent the administrators without diminishing his administrative capacity.<sup>10</sup>

Centralized and decentralized administrations have different costs and benefits. Historically, the sunk and agency costs of creating a decentralized administration were lower than for creating one that was centralized.<sup>11</sup> Decentralized administrators were often residual claimants and hence were better motivated and often also had better local information and knowledge. On

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<sup>10</sup> In other words, the distinction between a centralized and decentralized administration relates to that between social position and identity. In a centralized administration, the identity of the administrators does not matter. In a decentralized one, it does. Who the administrator is determines his effectiveness. Indirect rule is a specific case of a decentralized administration in which an outside ruler relies on a locally powerful elite – e.g., feudal lords or tribal chiefs – to govern on his behalf.

<sup>11</sup> This reflects the technologically determined high cost of information, communication, monitoring and transportation that prevailed at least until the recent past. See Greif 2007.

the other hand, a centralized administration had a cost advantage in implementing choices characterized by economies of scale, such as defense, flood control, or famine relief.

An *administrative structure* is a division of the total administrative capacity between centralized and decentralized administrations. Because each type of administration has different costs and benefits, structures will tend to be mixed ones with some centralized and some decentralized components.

Indeed, even in Absolutist France, the Crown found it necessary to rely on and even strengthen a decentralized administration. When the Bourbons came to power, they had a centralized administration for the collection of indirect taxes. They auctioned short-term leases to bidders who were perfect substitutes ex-ante and ex-post. The Military Revolution of the period, however, increased expenses faster than the increase in revenues. The kings found it was in their interests to renegotiate leases and renege on their contractual obligations. Once the farmers realized they, they made smaller bids and a budgetary crisis ensued. In response, Colbert, France's finance minister, created the 'Company of General Farms' in the second half of the 17<sup>th</sup> century, which became the sole collector of indirect taxes. The Company's ability to credibly threaten to halt collections fostered the Crown's commitment to pay debts, increased its net revenues, which resolved the budgetary crisis. (Balla et. al., 2006.)

Although most administrative structures are mixed, I will refer to an administrative structure as either centralized or decentralized, rather than more centralized or more decentralized. This facilitates the presentation.

### **Administrative Power and Self-enforcing Administrative Structures**

Under a decentralized administration, administrators can have administrative power. They have discretion in deploying their administrative capacity. Instead of implementing a choice, they can withdraw their services or even use their administrative capacity against the ruler (e.g., cease collecting taxes or rebel). The threat of sanctioning a ruler if he makes a particular choice is credible if the net benefits of implementing the choice is lower than the net benefit of sanctioning the ruler. If the threat is credible and the sanction is sufficiently costly to the ruler, his best response is not to make that choice. In this case, administrators have the administrative power to influence choices and the larger the set of choices from which they can deter the ruler, the higher

is their power.

A necessary condition for administrative power is that the cost of creating an administration be sufficiently high, which was historically the case (Greif 2007). Clearly, many groups – other than administrators – can act in ways that impose costs on their rulers. China’s rulers have always feared mass peasant revolts, while in democracies groups can punish politicians by coordinated votes against them.<sup>12</sup> Non-administrators, however, have to sanction the ruler by taking actions (e.g., revolt or vote) and face rulers that have administrations to confront them. The Chinese peasants had to face the army while those organizing protest votes in non-democracies have to face hostile administrations. In contrast, powerful administrators can impose costs on a ruler through inaction and face a weaker state apparatus.. Administrators therefore have a comparative advantage in sanctioning rulers.

It is intuitive that administrative power decreases when exogenous technological and environmental changes reduce the administrator’s capacity to sanction, increase the ruler’s capacity to retaliate and decrease the value of the future to the ruler. For example, changes in military technology that render economies of scale, coordination, and professionalism more important decrease administrative power (assuming that the ruler has the largest military contingency). The power of financial administrators declines if the ruler gains an independent source of income or gains access to alternative financiers. An increase in external military threats to which the administrators are more vulnerable than the ruler, reduces their administrative power.

Less intuitive perhaps, is that different levels of administrative power can prevail, as equilibrium outcomes, for a given technology and environment.<sup>13</sup> This is the case because administrative power is also a function of the administrative structure. Power is (weakly) increasing with the extent of decentralization because the administrators’ capacity to sanction increases. Similarly, the ruler’s capacity to retaliate decreases with decentralization. In the extreme case in which the administration is completely decentralized, the ruler has no retaliatory

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<sup>12</sup> Administrations may even have a comparative advantage in coordinating such protests. Moe 2005.

<sup>13</sup> The above comparative statics are thus relevant under the assumption that the equilibrium does not change qualitatively due to the parameter change.

capacity, and the administrators can sanction him with impunity.

The more decentralized the administration, the more power the administrators have and the greater is the set of choices they can prevent from being implemented. Indeed, in a sufficiently decentralized administration, they will have the power to prevent further centralization or even to further decentralize. In contrast, administrators in a mainly centralized administrations lack the power to prevent further centralization. Hence, there are at least two equilibria, decentralized and centralized.<sup>14</sup> In between them there are likely to be others in which neither side finds it beneficial to unilaterally change the structure. Once an administrative structure corresponding to any one of these multiple equilibria prevails, it is *self-enforcing*. In these cases, the administrative structure – whether commissioned by a ruler, created by the administrators, or inherited from the past – will perpetuate.

Historically, administrative power has derailed the choices of seemingly mighty rulers. Consider, for example, Frederick Barbarossa (d. 1190), who was the Duke of Swabia, the king of Germany, Italy, and Burgundy, and the Emperor of the Holy Roman Empire. In Germany he faced powerful administrators, the Dukes (some were later referred to as Princes), who governed various Germanic tribal areas. The power of one Henry the Lion, Duke of Saxony, was enough to prevent Barbarossa from regaining control over the Italian city-republics. Henry did not bring his army to fight in the decisive battle of Legnano (1176) in which Barbarossa was defeated and forced to recognize the autonomy of the cities.

Why was Barbarossa unable to pay Henry enough to participate? The problem is one of commitment. Administrative power is valuable because it increases the ruler's costs for making choices contrary to the administrators' interests. Hence, to motivate Henry to support his gaining tax revenues from Italy, Barbarossa would have needed to compensate him for losing future gains from his forgone administrative power. Even if Barbarossa could have provided this amount, he would have needed to commit not to use his enhanced administrative power to take it back *ex post*.<sup>15</sup> The only way to commit would have been to reward Henry in a way that sustained the balance of power between them. Barbarossa, however, did not have much to offer.

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<sup>14</sup> Each is more likely to correspond to the optimal structure for the administrators and ruler respectively.

<sup>15</sup> For a similar arguments see Greif 1994a; Fearon 1997; Nye 1997; Acemoglu 2003.

Indeed, Frederick Barbarossa seems to have inherited a mainly decentralized administrative structure that he could not alter. He was crowned the King of Germany in 1152 as a compromise candidate to end a long period of civil wars. During that anarchic period, many of the German Dukes established independent administrative capacities within their domains and Barbarossa lacked the centralized administrative capacity to dismantle them. After his defeat in Legnano (1176), which he attributed to lack of support from Henry the Lion, Barbarossa returned to Germany, fought Henry, and eventually defeated him. But Barbarossa was unable to reduce overall administrative power. The Dukes who assisted him were the ones who received Henry's territories. They were willing to assist the Emperor against a Duke, who had become alarmingly strong, but they were unwilling to let Barbarossa become equally stronger.

### **III. Administrative Structures, Political Cycles, and Violence**

This section notes that effective administrative structures are unstable and are undermined by the process they imply.<sup>16</sup> Transitions from one administrative structure to another, which can be lengthy, are usually violent. Hence, establishing any effective administrative structure – decentralized or centralized – ends a period of conflict and hence is economically beneficial at least for a period of time.

Decentralized administrative structures are generally self-enforcing in a relatively small set of parameters and hence unstable. Administrators must be deterred from seceding or deposing the ruler while the ruler has to be deterred from centralizing the administration.<sup>17</sup> These two conditions are difficult to satisfy simultaneously. A delicate power balance between the ruler and the administrators has to hold.

Furthermore, at least two processes tend to undermine decentralized administrations. They either dis-integrate or centralize. They dis-integrate because rulers have limited ability to

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<sup>16</sup> Self-enforcing institutions are undermined when they imply processes that decrease the parameter set within which they are self-enforcing. The discussion here ignores, for simplicity the impact of non-elites on administrative structures. Section VI returns to this issue and presents two additional undermining processes.

<sup>17</sup> The set of parameters within which the administrators are deterred from seceding is larger if the administrators are not men-of-arms (but, for example, financiers) and their power is lower and more diffused. This set of parameters increases with the gains from public goods provided by the ruler (e.g., defense or a monetary system).

monitor their administrators. After all, administrators have freedom of action. Hence, they can increase their power without the rulers' knowledge or comprehension of the results. The state can thereby disintegrate. Had the Mongols, for example, noticed the increasing military strength of the Muscovite Princes earlier, they would have confronted the Princes prior to 1380, when it was too late. Decentralized states are further centralized when the a ruler's decentralized administration provides him with the resources and security required to engage in politics, rather than fight for survival. He can therefore attempt to centralize his administration. Collective action and free rider problems as well as information asymmetry limit the administrators effectiveness in preventing this process. Distinct interests among the administrators and the possibility of manipulating them against each other further fosters a ruler's ability to centralize with impunity.<sup>18</sup>

Legitimate, long-lived rulers have historically been particularly effective at centralization.<sup>19</sup> The centralization of France by the Bourbons, for example, was facilitated by the large size of France that hindered coordination against them, the longevity of several monarchs, and the Military Revolution that increased economies of scale in military ventures. I am not familiar with a theory articulating the conditions under which dis-integration or centralization will transpire.

Centralized administrations are probably more stable than decentralized. For them to be an equilibrium, a sufficient condition is to prevent challenges to the ruler. Yet, at least two processes can undermine centralized administrations. First, the agency problem in the ruler-administrators' relations reduces his ability to prevent administrators from gaining power. He relies on the administration to gain information and hence may not be aware of decentralization activities.. Second, it is highly costly to create an effective centralized administration and it is organizationally challenging to adjust it to changing needs while retaining its effectiveness. Ineffective centralized administration, in turn, fosters the rise of actors with administrative

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<sup>18</sup> Centralization is more likely the lower the cost of creating a centralized administration, the lower the comparative advantage of the decentralized administration, the wealthier the ruler, and the higher the economies of scale in warfare.

<sup>19</sup> Indeed, historically lasting constitutional states – Athens, Rome, Venice, and modern Western democracies – were those in which rulers (e.g., Doges and presidents) and administrators (e.g., prime ministers and generals) have had relatively short tenures.



capacity. This was the case in late medieval Europe as discussed in section VIII.

Centralized France exemplifies how decentralized administrators gain further power and undermines a centralized regime. The Company of General Farmers created by Colbert to solve the Crown's budgetary problems gained administrative power as its operation became more efficient. By the eve of the revolution it was providing the Crown with more than one-third of its total royal tax revenues and about 40% of its operating budget. Indeed, it had so much power on the eve of the French Revolution that it blocked the proposed financial reforms that would have reduced its power (e.g., Root 1989; White 2004). Unable to reform finances, the Crown ended up summoning the Estates-General in 1789.

Late medieval Germany experienced a process of disintegration. Its administrators, the dukes, were military men, powerful relative to the emperor, and few in number. They took advantage of dynastic disputes and gradually transformed the Empire from a state to a confederation. In 1232 an Imperial declaration referred to the dukes for the first time as *domini terræ*, lords whose land was not held as a fief. By 1356, a subset of dukes was among the Prince-Electors who, until 1806, elected the King of Germany (also usually crowned as the Emperor). By the conclusion of Thirty Years War (1648), the German Empire had become a defense confederation of de facto independent principalities. The limits of disintegration were determined by the gains from the global public good.

Administrative structures are likely to change over time in cyclical manner. Decentralization implies processes leading to disintegration or centralization. Disintegration implies processes leading to centralization while centralization implies processes leading to decentralization. Hence, within a given geographical area, states are likely to centralize, decentralize, disintegrate, and re-centralize over time. Because such political transitions are violent, they prevent development and reduce prosperity and welfare. This is why the few pre-modern states with relatively lasting and centralized administration – such as China and the Roman Empire – dominate our history books. Many more empires disintegrated relatively quickly or decentralized. Examples include: the Parthian Empire, the Mongol empire, the Empire of Timur Leng, the Carolingian Empire, the Japanese Empire, and the Abbasid, Umayyad (Spanish) and Fatimids Caliphates. Indeed, even the Chinese Empire had periods of time when it disintegrated.

#### **IV. The Rule of Law and Political Institutions**

While they last and are effective, administrative structures influence legal and political developments. In particular, under decentralized administrations, administrative power renders the rule of law an equilibrium outcome and leads to the emergence of ‘constitutional’ legal and political institutions.

The rule of law, constitutional rights and representative assemblies are equilibrium outcomes when administrators are sufficiently powerful. More specifically, the rule of law has several components, the first being limited government, or a government constrained in making choices according to the law. A rule of law in this sense prevails when the administrators have power and rulers are better off respecting a particular right rather than violating it and triggering sanctions. The more power the administrators have, the more rights they can secure for themselves. The rule of law – expressed in customary, legal, explicit, or implicit rules – is an equilibrium outcome reflecting a balance of administrative power.<sup>20</sup>

Administrative power impacts payoffs to the ruler under various processes of decision making.<sup>21</sup> In particular, when facing powerful administrators, rulers gain from introducing two other components of the rule of law: equality before the law and due process. These reduce the probability of conflicts due to information problems by eliminating the ruler’s discretion when making legal and political choices.

To see the causal relationship, suppose, without loss of generality, that the ruler can structure the legal processes through which disputes concerning the administrators are resolved and political choices are made. Further suppose that unforeseen events can transpire, various variables are stochastic, asymmetric information prevails, different interpretations of actions and choices are possible, and monitoring is imperfect. Finally, suppose that the choices optimal to the ruler and administrators depends on these unforeseen events and stochastic variables and imposing

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<sup>20</sup> There is a rich literature that examines the relations between military or production technology and the rights that one can personally secure as an equilibrium outcome when facing a predatory ruler. (E.g., Olson 1993). This work differs in considering the institutional (non-technologically) determined foundations of the rule of law as an equilibrium outcome. For previous analyses in this spirit, see Greif 1994a, 1998; Bates, et. al. 2002.

<sup>21</sup> More exactly, the payoffs reflect the linking of the transaction of exchanging administrative services with those of exchanging legal and political rights. The latter is an auxiliary to the former. See Greif (2006, chapter 2).

sanctions is costly to the administrators.

In such an environment, costly conflicts will transpire on-the-equilibrium-path. Due to imperfect monitoring and the multiple possible interpretations of choices, for example, the administrators might believe that the ruler transgressed their rights or attempted to reduce their power. Therefore, periods of costly conflicts will transpire.

In feudal Europe, for example, decisions had to be made regarding estates held by a widow, a minor lord, or someone who had no legal heirs. Because feudal estates were given by the Crown, it was not unreasonable for kings to have the right to decide who might be entitled to marry a widow, serve as a regent, or become a new lord. But if a ruler had this discretion, he could make choices that would influence the balance of administrative power. For example, he could appoint someone as lord whose preferences were more aligned with his own than the administrators'. If he acted in this way, or was even perceived to be doing so, the administrators could find it optimal to sanction him.

The ruler and the administrators, therefore, could gain from adopting decision-making processes that improved the quality of information and reduced the likelihood of conflicts. Information quality improves when decisions on legal matters are rendered anonymously through a pre-determined due process. By relinquishing discretion and respecting legal procedures with outcomes he does not control, the ruler is able to signal that his choice is not aimed at influencing power. If his gains from reducing conflict are larger than the cost of losing discretion, introducing and respecting due process and equality before the law is his best response.

Barbarossa followed due process when he attacked Henry. He sought the Dukes' consent for the attack legally and they found Henry guilty of insubordination and declared him an outlaw. Similarly, even before the Magna Carta affirmed Barons' rights to be tried by their peers, English kings relinquished their legal cases to them. The Magna Carta also limited kings' rights to impose feudal death dues and set procedures for handling fiefdoms that were under the supervision of regents or widows rather than a adult male lord.

Constitutional rules – charters, golden bulls, constitutions, political traditions, or fundamental laws – similarly serve the role of reducing conflicts on the equilibrium path. In particular, constitutional rules specify the legal and political rights of both sides and processes for making decisions reduce the possibility of costly misinterpretations of choices. (Greif 2006.)

These rights and processes are equilibrium outcomes given the balance of administrative power.<sup>22</sup>

The history of the Magna Carta reflects three aspects of the above argument. First, it reflects the role of constitutional rules in mitigating informational problems. Second, it reflects that rules must be self-enforcing to be followed, and third, that conflicts is a means through which self-enforcing rules are selected. The first version of the Magna Carta was imposed on King John in 1215 by the Barons, who demanded and obtained many rights when he was not militarily unprepared for confrontation. In particular, they imposed 'clause 61' upon him which specified that kings must swear oath of loyalty to an independent baronial committee that could overrule their decisions, using force if necessary.

Later events indicates that clause 61 was not self-enforcing although the barons may have hoped to make it so by forcing King John to take the oath. John received an annulment of his oath from the Pope, gathered his forces, and invalidated the Magna Carta. The later version of the Magna Carta that was confirmed by King Henry III in 1225 and remained in force into the 19<sup>th</sup> century, did not include clause 61. Indeed, it contained only 37 clauses. Those that were not self-enforcing did not last and those that were clarified rights, prevented conflicts and served England well.<sup>23</sup>

Constitutional rules are inherently incomplete 'contracts' and the rights and choices they specify are not likely to remain optimal as time passes. Yet, when they are an equilibrium outcome, neither side can *unilaterally* alter them without risking conflict. E.g., a ruler risks costly retaliation if he increases taxes based on private information regarding a forthcoming external attack. Once private information is credibly revealed and unforeseen contingencies have transpired, however, a re-adjustment of rights can be *mutually* beneficial. Sharing information and coordinating on changing rights while preserving relative power is Pareto-optimal (for both ruler and administrators). Political assemblies are therefore beneficial as they facilitate sharing information and coordinating change. Like due process and equality before the law, assemblies

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<sup>22</sup> Multiple equilibria can exist and if the ruler chooses an equilibrium, he will choose the one most favorable to him. In reality of course, the equilibrium can be chosen in many ways, including through the conflicts that signal relative power.

<sup>23</sup> The question remained as to why these 37 clauses were in force for so long despite the decline in the Crown's power vis-a-vis the Parliament. One reason may be that the Crown never regained the rights that were relinquished in the Magna Carta. Another is that changes were made through various amendments.

foster the efficiency of changing rights and adjusting choices.<sup>24</sup>

However, assemblies are not a free lunch for rulers. As early as the time of Aristotle, it was clear that tyrants "don't allow [even] associations for social and cultural activities or anything of that kind; these are the breeding grounds of independence and self-confidence, two things which tyrants must guard against" (Politics 5.11). An assembly facilitates coordination among the administrators and hence their power is greater than the sum of its components. Thus, if the ruler does not gain much from changing rights and making new choices, he is better off not having representative assemblies.

This implies that states with weak administrators – centralized administrations – will not have representative assemblies (although rulers may still rely on various advisory councils). States with strong administrators – decentralized administrations – will have assemblies representing the administrators, but only if they face an unstable environment that requires adjustments of rights and choices.

While the relevant evidence has not yet been collected, a cursory historical examination confirms these predictions. In the late medieval period, political assemblies existed virtually throughout Europe. They were composed of individuals who either had administrative capacity (e.g., feudal lords), represented corporate bodies with this capacity (e.g., cities) or had a standing committee with administrative power.<sup>25</sup> Decentralized but internationally isolated Japan did not have an assembly but its administrators had the equivalent of the rule of law and the Shogun followed constitutional rules.

Histories of individual countries similarly confirm the above predictions. France's history, for example, confirms the relations between administrative power and constitutionalism and the undermining of decentralized administrations. The French Estates-General was first summoned in 1302 when the King, Philip the Fair, sought support for his conflict with Pope Boniface VIII. It was composed of powerful administrators, namely the chief lords, both lay and ecclesiastical, and

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<sup>24</sup> E.g., Bates 1991; Hoffman and Norberg (2001); Barzel and Kiser. 1997; Barzel 2002.

<sup>25</sup> For evidence, see Herb 2003. Greif 2007 develops the conjecture that the rise of limited monarchies in Europe reflects administrative power. Another evidence is that in late medieval Europe, administrators such as cities and lords each had particular 'liberties' that specified their rights. Position-specific rights are consistent with the argument developed here.

the representatives of self-governed towns. It was regularly summoned when the Crown needed financial support. This was the case during the Hundred Years War (1337-1453) and the Wars of Religion of the late 16<sup>th</sup> and early 17<sup>th</sup> centuries. The Estates-General was not summoned, however, from 1484 to 1560 when relative peace enabled the Crown to govern without it.

When the first Bourbon, Henry IV, was crowned in 1589 he embarked on centralizing his administration, particularly by using *intendants* to check the administrative capacity of the provisional government his nobles controlled. Centralization intensified, particularly from 1621-1661, under the able Chief Ministers, Richelieu and Mazarin. For example, the role of the intendants, who had previously been supervisors, was expanded to include tax collection. Alongside financial and legal administration, the Crown gained control over military power. The latter task was facilitated by the Military Revolution – changes brought about the introduction of cannons and firearms – which increased the relative advantage of a centralized army. Private fortifications within France were destroyed and the nobles' private armies dissolved.

The previously decentralized administrators attempted to prevent their power from being undermined. The once-powerful administrators, the feudal nobility and the officers of the Parlement of Paris often revolted, but the failure of the series of revolts during the Fronde (1648-1653) revealed their inability to defeat the king militarily. With a centralized administration in place, there was no need for the Estates-General, and after 1615 it was not summoned. Consistent with the argument, it was next summoned in 1789 when the Crown faced a financial crisis. The power of the Estates in the Revolution partly reflected the Crown's limited success in creating a centralized administration.

The histories of Russia and Poland suggest that multiple administrative structures can be self-enforcing in a similar environment, and that the initial administration matters for later developments. Furthermore, their histories support the argument regarding the causal relations between decentralization, administrative power and constitutional rights.

Moscow's initial rise to power came about when it functioned as the tax collector for the Mongol rulers. The Mongols bestowed the title of the Grand Prince of Moscow on the Muscovite ruler. The Grand Prince gathered taxes on their behalf using his centralized administration with the Mongol's military backing. By the middle of the 14th century Mongol power was declining. The Grand Princes revolted and gained independence after one hundred years of war following

their victory at Kulikovo (1380).

Initially, the hereditary high nobility (*boyars*) retained some administrative power and gained political representation in the Boyar Duma. Consistent with the argument here, as the economic importance of the Church and cities increased, an ‘assembly of the land’ (*zemsky sobor*) was created (1459) with representation from the nobility, those high in the bureaucracy, the Church, and the towns. Once the war with the Mongols ended, however, the Princes of Moscow began to further centralized their administration.

During the 15<sup>th</sup> and 16<sup>th</sup> centuries, the Princes, particularly Ivan III and Ivan IV, gradually restricted the boyars’ power, created a standing army (the *Streltsy*), and for a period ruled as a private domain over about a third of Russia. They similarly militarily destroyed the prosperous city-republic of Novograd. The autocratic intentions and successes of the Princes of Moscow is well reflected by Ivan IV assuming the title of Tzar. Increasing administrative centralization reduced the Tzars’ dependence on the assembly of the land.<sup>26</sup> After 1654 it met only twice and in 1684 it met for the last time. The Boyar Duma was abolished in 1711. Administrative centralization ended whatever small degree of constitutionalism Russia possessed.

Poland was one of the main powers with which the Russians had to contend. Despite similar technologies and natural endowments, pre-modern Poland was not an autocracy. Indeed, the Commonwealth of Poland-Lithuania was a limited monarchy from 1569 to 1795 (when it was partitioned by other European powers). It even adopted the US Constitution in 1791. In the Kingdom of Poland a political assembly (*sejm*) had probably existed since the 12<sup>th</sup> century. Consisting of nobles, clergy, elected local representatives, and particularly landlords. Lacking a centralized administration, the king became increasingly dependant on the military services provided by the landlords. Once they became military administrators, they gained more power. By the 16<sup>th</sup> century, the assembly was summoned every year and elections were held every other year. It elected the king and made final decisions in legislation, taxation, budgets, and foreign affairs. Constitutional laws specified rights and the lower house was able to progressively gain more rights.

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<sup>26</sup> The assembly was rarely able to effectively object or impose its will on the Tzars. But in 1598 and 1613 it was the entity that appointed the new Tzars once the previous dynasty died out.

Poland's distinct institutional trajectory seems to reflect a different process of state formation. The Polish rulers did not initially function as tax collectors supported by an occupying military force. Instead, Polish kings consolidated – but did not conquer – a land divided into many principalities with local aristocracies that had administrative power. The initial self-enforcing decentralized administration did not provide the kings with the resources required for centralizing the administration.

The rule of law, constitutions, and political assemblies are a means for reducing conflicts and gaining from adjusting rights and making choices in the presence of administrative power.<sup>27</sup> Clearly, constitutional institutions will emerge through similar processes and fulfill similar roles when rulers are deterred from abusing rights by threats such as of popular revolts. Yet, as presented above, there are good theoretical and historical reasons to maintain that administrative power led to constitutional institutions.

## **V. Political Institutions and Economic Prosperity**

It is often claimed that constitutionalism promotes prosperity by securing property rights and fostering socially beneficial policies. England became the canonical example, and according to this interpretation of English history, it prospered after the Glorious Revolution (1688) because constitutionalism secured rights and promoted markets (North and Weingast 1989). Yet, after the Revolution, England also witnessed some of the greatest property rights abuses in its history, such as enclosure of the open fields, higher taxation of unrepresented Englishmen, and land grabs in Ireland and in the colonies (e.g., O'Brien 2001; Harris 2004).

This section resolves this apparent contradiction by noting that when decentralization underpins constitutionalism, it does not necessarily better prevent abuses or lead to welfare-enhancing policies. First, constitutionalism can foster the ruler's and administrators' ability to abuse the rights of the *non-elite*. Second, when choosing and implementing policies, the ruler and administrators take into account the policies' implications on the balance of power. The resulting policies will therefore reflect power considerations and not just welfare. More generally, the

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<sup>27</sup> Term limits on posts for political executives reduced a ruler's ability to become administratively powerful.



interests of the administrators will have a disproportionate influence on policies.

Constitutionalism, nevertheless, is more beneficial when the economic interests of the administrators are aligned with those of the broader society. It also offers an institutionalized way to aggregate information and mobilize resources to implement welfare-enhancing policies.

When rights and constitutional institutions are an equilibrium reflecting administrative power, the rights of those without administrative power may not be better protected than their equivalents in non-constitutional states. Consider the rights of peasants in constitutional Poland and absolutist Russia. The increasing administrative power of the Polish landlords enabled them to gradually expropriate rights from the peasants. Taxation increased, mobility was restricted, and the peasants were gradually subjugated to serfdom. The situation in Russia was not much different. As the centralized power of the Tzars increased, the Russian peasantry was subjected to serfdom. The main distinction between the two cases reflects a different distribution of administrative power. In Poland, the landlords gained from serfdom while in Russia, the Tzars benefitted.

As a matter of fact, constitutional institutions benefitting the elite can be socially harmful exactly because they are 'good' at fostering intra-elite cooperation. In particular, they foster the ability of the ruler and administrators to abuse the rights of non-elite. The Great Peasants Revolt (1381) in England transpired following a decision by the King and Parliament to triple the poll tax. Similarly, following the Glorious Revolution (1688), cooperation between the King and Parliament was enhanced. After that, as mentioned above, England witnessed some of the greatest property rights abuses in its history. Better institutions for the elite do not necessarily imply good institutions for others.

Furthermore, rulers with decentralized administration have theoretically ambiguous incentives to protect the non-elite. The issue is how abuses impact power. On the one hand, rulers' benefit from preventing abuses that increase the administrators' power. Late medieval European rulers were supposed to provide justice. The summary of Frederic Barbarossa's duty is representative. His duty "was merely to protect all the subjective rights everybody had ... he was supposed to play [the ..] role as law protector" (Munz 1969: 100). On the other hand, when rulers are unable to prevent abuses that increase administrators' power, they can benefit from socially-inefficient policies that checks it. The Ottoman Sultans enacted policies that favored their tax-

base in Istanbul but hindered growth in the provinces administered by governors who might have challenged them. (Kivanc 2006.)

Whether constitutionalism prevailed or not, those making political choices (regarding economic institutions and policies) consider their impact on administrative power and will not choose socially beneficial choices that undermine their own powers. The ruler's and the administrator's objectives not to lose administrative power create a wedge between socially optimal economic institutions and policies and those that are optimal for rulers and administrators.<sup>28</sup>

Comparisons between England and the Polish-Lithuanian Commonwealth exemplify that the welfare implications of limited monarchies depend on their administrators' interests and concerns over maintaining their power. Comparing these two states is informative because, as noted above, from 1569 to 1795 the Commonwealth was a constitutional monarchy comparable to post-1688 England. It was also a major European state extending over contemporary Poland, Lithuania, Belarus, Latvia, the western part of Russia, and much of the Ukraine and Estonia (e.g., Stone 2001). Although constitutional institutions prevailed in Poland, prosperity did not. Why was this the case?

The security of rights was insufficient to bring prosperity to the Commonwealth because those with administrative power opposed choices that would have promoted it. In the Commonwealth, administrative power rested with the landed aristocracy who were engaged in export-oriented commercial agriculture. Fostering prosperity required policies that encourage urbanization, markets, and industry, which potentially would have led to rival administrators with different interests. The aristocracy therefore pursued policies, such as serfdom, that increased their profits without undermining their power.

In 17<sup>th</sup> century England the parliamentarians were engaged in agricultural production for domestic consumption, commerce, finance, and industry. Their interests lay in policies that fostered market expansion and internal demand. Prosperity was the result. The 17<sup>th</sup> century Civil War and Glorious Revolution were followed by both an increase in the administrative power of

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<sup>28</sup> Both sides have incentives to introduce reinforcing institutional elements that make a Pareto-optimal allocation self-enforcing ex-post. See Greif 1998, 2006.

the Parliament and policies that supported commercial expansion overseas. England built the largest Navy in Europe, enacted the Navigation Act, fought the Dutch and French for control of the seas, and created an Empire abroad. While this Empire did not benefit all Englishmen all the time, in the long run it contributed to the general prosperity of the population. In England, unlike the Commonwealth, the interests of those with administrative power were in line with that of the economy at large.<sup>29</sup>

In non-constitutional regimes, concerns over the impact of economic institutions on administrative power can similarly prevent welfare-enhancing choices. Consider the process that led to the development of modern markets (Greif 2005). For a market to exist, contract enforcement institutions are necessary. In particular, contract enforcement can be provided by private-order that do not rely on the power of the state to enforce contracts but rather on reputation mechanisms and informal means to enforce contracts. Yet, the rise of the modern market economy – whose hallmark is impersonal exchange – requires public-order institutions provided by the state. Complementing private-order with public-order institutions is the direct factor that led to the rise of the modern market economy in the West.

Why weren't non-European economies, such as China's, which had more developed markets in the pre-modern period (Shiue and Keller 2003), not the first to develop a modern market economy? The Chinese emperors could have gained from better markets. They recognized that maintaining order in a vast Empire with large cities and millions of peasants required preventing the food shortages that were inevitable given the imperfections of spatial and inter-temporal markets. Yet, they did not create an administration to enforce contracts in mercantile transactions.

The absence of public-order institutions to enforce mercantile contracts is particularly puzzling given that China developed an effective administration at least by or before the Zhou Dynasty (1122-256 BC). It enforced contracts regarding taxable assets such as land (e.g., Zelin,

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<sup>29</sup> A puzzling observation is that the policy of overseas commercial expansion was not carried out by Parliament prior to the Civil War. A rational account for this is that such a policy could have undermined the parliamentarians' administrative power prior to the war. The Crown lost its rights to collect custom revenues during the Civil War. As long as the Crown collected customs, commercial expansion overseas would have altered the balance of administrative power in its favor. The Crown lost these rights during the Civil War and the Parliament therefor could pursue a policy of commercial expansion without undermining its power.

et. al. 2004). Yet, the authority of this legal administration did not extend to market exchange in general. For most of its history there was no commercial code of law and the magistrates who administered justice were discouraged from adjudicating commercial disputes. This did not change until its encounter with the West.

The pre-modern Chinese market economy was therefore based on private-order contract enforcement institutions. The market “consiste[d] of networks of people whose actions are oriented by normative social relationships” (Hamilton 1994: 199). The Emperors prevented the creation of a powerful administration that could have challenged them although it probably would have been socially beneficial. It was the relative absence of the state from the commercial sphere that hindered further market development and led to an institutional evolution that was different from Europe’s (Herrmann-Pillath 1999). More generally, the Chinese state was less involved than Europe in its economy (Wong and Rosenthal 2006).

The discussion provides a consistent explanation to this puzzling observation. In a centralized state, such as China’s, the ruler’s cost of creating public-order contract enforcement institutions increases if doing so enhances the power of the administration. When complex markets depend on public-order contract-enforcement institutions, the administrators in charge of these institutions gain power. Once it acquires the human capital and organizational capacity required to adjudicate disputes in a complex economy, the administration becomes costly to replace. When the economy depends on it, shutting it down is costly to the ruler. These considerations may have deterred the Chinese Emperors from creating public-order institutions to enforce contracts.

The absence of the Chinese state from the commercial sphere reflects an important factor rendering constitutionalism potentially more conducive to promoting welfare. Under constitutionalism, administrators have political voice and influence. They have an institutionalized way (assemblies) to aggregate information and knowledge about economic issues and they can influence economic policy. When the administrators are a military elite (as in Japan) this feature of constitutionalism does not matter. When they are economic agents whose interests conflict with economic prosperity (as in Poland), this feature will be welfare-reducing but when their interests are aligned with economic prosperity, these features are welfare-enhancing. The responsiveness of rulers to the economic interests of the administrators in constitutional states

make them more likely to pursue growth-enhancing policies. This particularly benefitted Europe where many of the administrators were landlords, commercial cities, and business corporations.

Decentralized administrations have another, arguably more important, advantage in fostering prosperity that reflects the sources and implications of the political conflicts decentralized administrations engender. The next two sections will develop this argument.

## **VI. Different Administrative Structures Lead to Distinct Political Conflicts**

Political conflicts are attempts to alter the composition of the elite. This section argues that different administrative structures make distinct types of political conflicts more likely. Specifically, because centralized administrations have a comparative advantage in controlling non-elites, political conflicts are more likely to occur among members of the elite (*intra-elite* conflicts). Decentralized administrations have a comparative dis-advantage in preventing the non-elites from gaining enough resources to challenge the elite. Political conflicts are therefore more likely between the elite and an aspiring emerging elite (*inter-elite* conflicts).<sup>30</sup> The implications of this observation on economic outcomes will be discussed in the next section.

Centralized administrations have a comparative advantage in controlling the non-elite by preventing actions the elite do not authorize and punishing the non-elite who carry them regardless. This comparative advantage reflects the institutionalization of routines for coordination, monitoring, and information sharing in centralized administrations as well as the ability to concentrate resources to suppress deviants. Furthermore, the rulers who create centralized administrations internalize the costs of political challenges and hence will invest more to prevent and contain them.

In contrast, decentralized administrators are likely to have different costs and benefits from various choices. They also face free rider and collective action problems. Changes unauthorized by all the elite will therefore be more likely to transpire. Consider decentralized England where the Justices of the Peace administered its counties from 1361 until the 19<sup>th</sup> century. They were responsible for guarding the king's peace and hence were required, among other duties, to enforce the law, fix wages, regulate food supplies, and maintain roads. Despite

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<sup>30</sup> The closest corresponding concepts are 'political revolutions' and 'social revolutions' in Skocpol, 1979.

this heavy load, the Justices were unpaid. Needless to say, they exercised discretion in what they implemented and were more responsive to local needs than choices made in London. English kings repeatedly failed to implement mercantilist policies, for example.

Because decentralized administrations have a comparative dis-advantage in preventing the non-elite from challenging the elite, *inter-elite* political conflicts are more likely. They occur between the incumbent elite and an aspiring elite trying to gain political voice and influence. Centralized administrations have comparative advantage in controlling the non-elite and preventing them from accumulating resources. Inter-elite challenges will therefore be less likely. When they do transpire, conflicts with the non-elite in centralized regimes do not arise from changes in the non-elite's strength but from growing desperation among the non-elite.

To explore what kinds of conflicts can nevertheless occur under a centralized administration, the concept of the 'elite' must to be further developed. Elite has been defined as those whose preferences influence political choices. It consists of the ruler and administrators when the administration is decentralized, and of the ruler alone when the administration is centralized. Yet, even a ruler with a centralized administration has to rely on some inner-elites composed of advisors, top administrators, generals, etc.. When random events or undermining processes alter the balance of power within this group of inner-elite, *intra-elite* conflicts will be the result.

Intra-elite conflicts are also more likely because there is a centralized administration that can be captured to serve the interests of a subset of elites. In particular, centralized administrations are vulnerable to capture by those who coordinate the administration on behalf of the ruler for two reasons.<sup>31</sup> First, centralized administrators have no power. Each is provided with incentives to implement choices made higher up in the hierarchy. Second, rulers have to allocate their finite time to many tasks. Hence, they often rely on intermediaries – such as viziers, chancellors, and prime ministers – to form and communicate choices so the administration can implement them. Reliance on an intermediary is also necessary when the ruler is unable to govern due to sickness, infancy, or old age. An intermediary, however, can use his authority to implement choices that will enable him to become a de-facto or de-jure ruler.

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<sup>31</sup> Even if they don't have administrative power and can be replaced.

History is rich with examples of intra-elite conflicts in centralized states for these reasons. Consider, for example, the Merovingian dynasty, which was the first to rule the Frankish Kingdom, from the fifth to the eighth centuries. Although the administration was initially decentralized, the chief officials, the Mayors of the Palace, were able to gradually strengthen the central administration. By controlling it, the Mayors became de facto the rulers and over time, the de-jure rulers.

The importance of capturing the administration in becoming the new rulers is reflected in a Papal Bull issued at the request of Pepin the Short, the Mayor of the Palace. The Bull confirmed that the person with de-facto ability to implement choices should be the king, rather than the one with the title of king. In 751 Pepin was elected the King of the Franks, sent the last Merovingian king to a monastery, and the Carolingian dynasty came to power. The Bourbons, another French dynasty, may have learned this lesson of history. Many of their Prime Ministers were members of the clergy and hence without legitimate heirs and dynastic ambitions.

Because decentralized administrations have a comparative disadvantage in maintaining control, they are more likely to engender inter-elite political conflicts, that is, conflicts with a new emerging elite. This has important implications for economic growth.

## **VII. Political Conflicts, Constitutionalism and Economic Growth**

Intra and inter-elite political conflicts have distinct economic interpretations and implications. Intra-elite conflicts concern re-distribution of influence over choices and hence of wealth from one subset of the elite to another. They are zero-sum games. Inter-elite conflicts are concern the re-distribution of political rights to those who have created new wealth. They are positive-sum games. Intra-elite conflicts are wasteful while inter-elite conflicts are a component of a system that fosters growth.

The comparative dis-advantage of decentralized administrations in maintaining control provides the non-elites with opportunities to create new wealth through economic initiatives, creativity, investment and labor.<sup>32</sup> Those who challenge the elite have something to offer in

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<sup>32</sup> They can acquire military resources rather than wealth. Yet, the value of this option decreases because the process described below is self-reinforcing in the sense that the larger the elite becomes, the more difficult it is to mount a revolt or a coup.

exchange for political rights. Moreover, they are likely to offer sources of wealth complementary to that of the elite. This reflects that the decentralized administrators – who are part of the elite – are likely to be better at controlling the non-elite in the elite’s area of economic activity. Hence, the non-elite are more likely to develop a source of wealth complementary to that of the elite. If accepted into the elite, the total pie will be larger than before while avoiding costly violent confrontation.

Resolution of these inter-elite challenges is also facilitated by institutionalized means for resolving political conflicts. Because decentralized administrations are more likely to imply constitutionalism, the elite will be more likely to have this institutionalized way of conferring rights without giving up their own. Inclusion of new groups in constitutionalism is a quantitative, rather than a qualitative, change. If inclusion is the expected outcome, the prospect of both economic and political rewards will motivate further wealth creation. The expansion of constitutionalism and economic growth are mutually complementary in a given period and will reinforce each other over time.

Combining this argument with those made in section V highlights reasons why economic growth has been historically rare and why modern growth initially transpired in relatively decentralized, constitutional states. It has been rare because many conditions have to be satisfied. In particular, a virtuous growth cycle is more likely where the decentralized administrators have economic interests aligned with prosperity, the administration is sufficiently effective in preventing internal violence and external attacks, but is nevertheless sufficiently ineffective in preventing the non-elite from creating new wealth. A virtuous growth cycle is also more likely where the technology and environment are such that there are new potential sources of wealth (e.g., commerce) to complement the elite’s (e.g., agriculture), and constitutionalism provides a non-violent means to expand the elite.

In contrast, the comparative advantage centralized administrations have in controlling the non-elite undermines their incentive to create new sources of wealth. Conflicts are more likely to be intra-elite and they concern mutually exclusive shares of the same economic pie. Pareto-improving resolutions are more difficult to achieve and the only institutionalized way to gain rights is through violence and by capturing the centralized administration. Expectations of intra-elite conflict motivate its member to waste resources in securing their position in the court,



eliminating competition, and safeguarding their assets in case they lose power. A vicious cycle of economic stagnation and byzantine politics is the result.

Rent provided to motivate the inner-elite to support the regime further weakens incentives to create new wealth. Rent requires exclusivity of membership, which was often hereditary (e.g., Russia) or even meritocratic (e.g., China). Limiting the distribution of rent to a selective elite or promoting wasteful competition for political posts (Yang 2002) further weakens incentives and capacities to produce new wealth. Low economic growth and high population growth in general reduce the available rent, further increasing the likelihood of intra-elite conflicts.

Centralized administrations may initially lead to economic growth while avoiding political conflicts. Rulers are fearful of mass revolts whenever the military technology, environment, demography, or intra-elite politics render a threat of revolt credible and its costs, high. In this case, rulers seek ways to promote the non-elite's welfare.<sup>33</sup> The Chinese Emperors, for example, recognized that destitution might ignite mass peasant revolts. They invested heavily in public goods, such as flood control and in operating granaries to prevent famines. The Qing Dynasty capped land taxes independent of productivity and various dynasties opened frontiers for cultivation and invested in increasing agricultural knowledge and productivity. All these activities were aimed at pacifying the population while preventing them from gaining the resources to challenge the regime. In the absence of new sources of wealth, population growth eroded the standard of living over time.

### **VIII. Distinct Historical Trajectories of Economic and Institutional Developments**

While systematic evidence regarding the impact of different administrative structures on political conflicts and growth are has to be collected, anecdotal evidence offers support. Consider, for example, the Muslim world. Its rulers often governed states with different ethnic compositions and were vulnerable to accusations of violating religious laws. They often responded by populating their central administrations with *mamelukes* (slaves). The *mamelukes* were not affiliated with any local ethnic group and could be legally punished more severely than freemen

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<sup>33</sup> They did not fear mass revolts when the non-elite were very oppressed. They therefore had no ability or incentive to create new sources of wealth and stagnation followed.

without breaking Islamic law.

Slaves, groomed to be administrators, were usually bought as young boys and trained together for civilian and military posts. They were often members of a distinct ethnic group, usually Slavic or Turkish. These conditions favored their coalescence into a distinct subset of the elite. What Muslim rulers did not recognize or considered to be the least worst outcome was the threat this sub-elite presented.

A notable example is provided by the history of Egypt. After 1174 it was ruled by the Ayyubids Dynasty established by Saladin. These Kurdish rulers enjoyed little popular support among the local Arab population and relied heavily on administrative services provided by Slavic mamelukes. The mamelukes' military power was balanced with that of other military contingencies. In the mid 13<sup>th</sup> century, the mamelukes took advantage of a dynastic conflict among the Ayyubids and weakness of the rest of the army. They revolted, deposed the Ayyubids, and began ruling Egypt. Initially, the mamelukes revived the economy. They labored, in particular, to promote trade by building a system of fortified resting places for merchants along main roads. They also promoted, yet heavily regulated, trade with the Far East and Europe. Intra-elite conflicts, however, were common and taxation was heavy. This, combined with outside invasions, caused the economy to decline.

In 1517, the mamelukes were defeated by the Ottomans. Ironically, the Ottoman Sultans were not spared from the rise of a mameluke elite. They had depended on *kapıkulu* ("door slaves") of European origin to provide them with elite troops and personal guards since the 14<sup>th</sup> century.<sup>34</sup> Before long, a subset of them, the *janissaries*, became a unified and distinct component of the elite. From the mid 15<sup>th</sup> century until 1826, they used their position as the military power in Istanbul to redistribute wealth in their favor – sometimes after killing the Sultan – at the expense of other members of the elite and the Ottoman Empire as a whole.

Initially they gained the right to marry and receive wage increases but like the Praetorian Guard before them, they gradually extracted more rights. By the 18<sup>th</sup> century, they had become a dominating hereditary elite who had gained extensive properties and economic privileges. They

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<sup>34</sup> The Ottoman Empire had elements of both centralized and decentralized administrations and experienced many changes over time.

prevented policies (such as modernizing the army) that would have undermined their power. By the 19<sup>th</sup> century, more than one hundred thousand Janissaries were being paid although most of them contributed little, if anything, to the administration. Not until 1826, when the Janissaries revolted, were they defeated by army units loyal to the Sultan.

It is difficult to evaluate the contribution of this intra-elite conflict to the economic and political decline of the Ottoman empire. Yet, the Janissaries' direct and indirect impact was probably great. Large sums were involved as well as crucial policy issues (such as modernizing the army). Intra-elite conflicts might have also led to the mis-allocation of resources as suggested by the history of the *waqfs* (religious charities), which were usually established by members of the elite to provide local public goods. They were legally required to invest in real estate and their wealth was enormous. In 1923, three quarter of Turkey's arable land belonged to waqfs (Kuran 2001). The rigidity of their governance, however, cost the Ottoman economy dearly. Kuran noted that members of the elite increasingly created waqfs to protect their assets from confiscation by the state. But why was the elite fearful of the state? Where intra-elite conflicts are common, members of the elite are insecure.

The process of European economic and institutional developments corresponds to that induced by the decentralized administration provided by economic agents.<sup>35</sup> The late-medieval European states were established by rulers who had little administrative capacity. Their abilities were so meager that many of them could not support a stationary court and had to travel throughout their kingdoms and consume local products, as late as the 11<sup>th</sup> century. "The travels of the Holy Roman Emperor Conard [for that reason] in 1033 were fairly typical. He traveled some 1600 miles" (Webber et. al., 1986: 168). After the 11<sup>th</sup> century, outside raids on Europe subsided and rulers gradually acquired greater administrative capacity. They mobilized larger armies, collected higher taxes, and administered justice.

This process of state formation transpired in the context of intense, existential, intra-European political competition that led to the destruction of such kingdoms as the Kingdom of Upper Burgundy and the Kingdom of Provence. Rulers began to rely on administrative services

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<sup>35</sup> It was facilitated by many factors: by the fact that these administrators were often corporations (and hence 'constitutional'), by European individualism (which fostered institutions supporting impersonal exchange), the Roman, secular legal tradition, and legitimate, hereditary rulers.

provided by lords (secular and ecclesiastical) and economic corporations – mainly self-governed cities (communes) – that had acquired administrative capacity during the period when states were incompetent. Rulers who failed to comprehend the advantages of constitutionalism in this situation often paid dearly. The German Empire lost Italy and Swiss cantons. The English, Spanish, French, Polish, and most other European rulers learned the lesson or had the foresight to adopt constitutionalism.

Decentralized administration provided by economic agents (the feudal lords) entailed opportunities for the non-elite to develop new sources of wealth in commerce and industry to complement agricultural production. Italian cities, for example, offered tax exemptions to craftsmen who created new industries in their regions while the Count of Champagne labored to safeguard merchants traveling to the international fairs he established. New technologies were invented as well as economically beneficial arrangements and organizations, such as the patent system, insurance contracts, banks, and central banks. Existing self-governed cities expanded and new ones were established, particularly in Italy, Flanders, France, and England.

Cities gained administrative power, received political rights and joined the elite. They collected taxes, administered welfare, dispensed justice, regulated their economies, and raised armies and navies. Not everyone benefitted, however. Those whose administrative power declined, lost rights. The French cities, for example, were important in crushing revolts by peasants demanding rights.

Constitutionalism offered a framework that facilitated mutually beneficial adjustments to rights as circumstances changed. Cities were represented in parliaments throughout Europe. It also fostered intra-elite adjustments of rights, as reflected in the institutional development leading to the rise of impersonal exchange in Europe (in contrast to its non-emergence in China described above).<sup>36</sup> From the late medieval period, inter-commune impersonal exchange was based on the Community Responsibility System (Greif 2006). Essentially, if a member of community A defaulted on a contract with a member of community B, each and every member of community A was held legally liable for the damage. If community A refused to compensate the damage, any

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<sup>36</sup> For the system to work, one had to know the personal and communal identity of his partner in the exchange. It was impersonal in the sense that the parties did not rely on reputation mechanisms.

member of community A who wandered into the territory of community B had his property confiscated as a compensation for the damage. The innocent merchant then had to settle the account with the member of his community who had defaulted. Community A had to choose between ceasing to trade in B or punishing a defaulter to deter cheating. When the cost of ceasing trade was high, traders could commit to being honest and impersonal exchange became possible.

For various reasons, by the late 13<sup>th</sup> century many European communes (that were administratively important) attempted to abolish the system and replace it with centralized contract-enforcement institutions based on individual legal responsibility. England was particularly successful at gradually making this transition. Its experience suggests that constitutional institutions were important in facilitating mutually beneficial, institutional changes that satisfied the constraints of maintaining the balance of power.

The King, Edward I, established a legal administration that facilitated contract enforcement in impersonal exchange based on individual legal responsibility. In the absence of compensating changes, this centralization power would have undermined the communes' administrative power.<sup>37</sup> By that time, the communes' administrative power was already high and the commune gained political representation. The King established, in the Model Parliament of 1295, the communes' right from representation in the Parliament. He consented that the approval of the Parliament (rather than that of the nobles' Great Council as specified in the Magna Carta) would be required for taxation.<sup>38</sup> Further compensation for the increased centralization was the law that each (wealthy) member of the commune would arm himself (according to his means) and join the local militia. The king mitigated the free rider problem that would have weakened the communes' military capacity to confront him by making participation mandatory.

This late medieval process of economic growth and expansion of constitutionalism, however, was fragile. By the 13<sup>th</sup> century, some European regions were too decentralized. The Italian cities won their independence but therefore no longer had a ruler to prevent inter and intra-city violence or coordinate defense against common enemies. Germany's disintegration similarly

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<sup>37</sup> Note that in centralized China (discussed above), providing public-order in mercantile contracts would have created powerful administrators while in decentralized England, the opposite was the case.

<sup>38</sup> As noted above, self-enforcing exchange of rights does not always exist.

weakened the process of wealth creation and elite expansion. Constitutionalism remained on the level of the election of the Emperor by the Great Princes and Free Cities. But within their domains, lords had a centralized administration.

In other regions, centralization undermined the growth process. France gradually but only partially centralized. The Court, the nobles, and the Church constituted the elite that slowed growth by extracting rent from the commoners, the non-elite. The inflow of resources from the New World to the kings of Spain and Portugal fostered centralization and the virtuous cycle of economic growth and constitutionalism was reversed. The Dutch provinces broke away from the Spanish monarchy, resisting heavy taxation and religious oppression. The revolt was led by the Provincial estates, the decentralized administrators of the Spanish monarchs.

The resulting decentralized Dutch Republic was governed by administrators who were economic agents. It became Europe's engine of growth. But its geo-political position required it to devote many resources to battles it often won but it could not profit from. The Dutch Republic's internal organization – a confederation of provinces – was also too decentralized. In particular, its navy was composed of these provided by each province separately. It did not withstand the onslaught the professional, centrally organized navy that England placed to confront it.

In England, the initial fragmentation of the administration, the weakness of the king, some luck, and a favorable geo-political position kept the engine of growth and constitutionalism humming, although not always smoothly.<sup>39</sup> The process benefitted, for example, from the fact that the Wars of the Roses (1455-85) decimated the ranks of the high nobility. This led to a powerful yet highly decentralized administration (in which the Justices of the Peace were an important component). Political stability was enhanced by the fact that no single administrator was powerful enough to seek independence or benefit from it. London might have been the exception given its size. Yet, it was a corporation controlled by a mercantile elite and the kingdom's economic center. The city had much to lose and little to gain from seeking independence.

Decentralized England gave rise to a sequence of groups that enriched it by creating new

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<sup>39</sup> Successions were often controversial in England because kings had little power but the monarchy was strong because the administrators depended on the public good – social order – it provided.

sources of wealth that were then constitutionally incorporated in the existing elite. Consider the following two examples which reflect the relations between decentralized administrations and wealth creation. The Mayor's court at London's Guildhall judged that negotiable credit instruments were legal in England (1436). It was good for the city's commerce. The king, who opposed the legality of the instrument, requested the case to be transferred to the King's Bench. The Mayor of London refused, arguing that according to "the ancient liberties and free customs of the city itself... the mayor ... have the power and use of hearing" such cases (Munro 1991: 74). The king withdrew his demand.

Similarly, when the first factories were opened in England during the Industrial Revolution, they were breaking the law. Only qualified craftsmen were legally permitted to produce industrial products and any production process that did not require their human capital was against their interests. Factory owners therefore employed individuals who were not legally qualified to manufacture industrial products. The local authorities, whose interests were served by the factories did not enforce the law. As previously observed, decentralized administrations did not necessarily benefit everyone. Labor activists, for example, were sent to Australia by local authorities for demanding that the authorities enforce the law.

More generally, this complementary and self-enforcing process of constitutional development and economic expansion was perpetuated in England for centuries. Self-governed cities were formed in agrarian England in the late medieval period, the gentry rose after the Wars of the Roses (1455-85), the overseas commercial expansion of the 17<sup>th</sup> century gave rise to a mercantile elite, and the industrialization of the 18<sup>th</sup> and 19<sup>th</sup> centuries led to the rise of an industrial elite. These new elites brought new sources of wealth to complement those of the incumbent elites, they gained political representation, and thereby were incorporated in the elite. The aspiring new groups did not displace the previous elites but joined them (Wasson 2000). The English feudal lords, for example, benefitted from the late medieval urbanization that increased the value of their agricultural estates. The commercial elite benefitted from the Industrial Revolution that increased England's trade (Mokyr, in this volume).

### **Concluding Comments**

It may well be that Europe's late medieval decentralized administration that was

controlled by economic agents contributed much to its subsequent economic and political development. Yet, the liberal economy and democracy of the modern period were not pre-ordained and indeed, in many states the advancement of constitutionalism and prosperity ceased or even reversed. The final outcome owes much to historical contingencies and chance events that kept progressively smaller numbers of states moving toward liberal democracy. If all European rulers had had their way, however, constitutionalism in Europe would have come to an end. Europe would have joined the ranks of most other regions where such institutions either did not emerge or did not survive to the modern period. The comparative advantage of centralized administrations in preventing changes and extracting rent would have undercut the incentives to create new wealth. Political conflicts would have taken place either within the elite or between them and the destitute.

Once England emerged as a liberal state, other European states adopted similar models. The institutional elements inherited from the constitutional past, in particular, the legitimacy of representative assemblies, the belief in the right to representation and in the possibility of self-governance probably facilitated this transition. These institutional elements facilitated the adoption of the liberal model while popular demand – reflecting this constitutional heritage – and inter-state competition motivated the elites to adopt it.

Further research is required to evaluate the merit of this comparative interpretation of distinct historical trajectories of economic and institutional developments. Whatever the conclusion, the preliminary analysis in this paper provides ample evidence that suggests administrative power impacts economic and institutional developments.

Decentralized administrations are more likely to render constitutionalism an equilibrium outcome and be growth-promoting through its relative inefficiency in controlling the non-elite. The resulting inter-elite conflicts are about how to divide a bigger pie and therefore a Pareto improving solution is therefore more likely to exist. Constitutionalism, in turn, provides a means to incorporate the new elite without disenfranchising those in control. Initial administrative decentralization and administrators who are economic agents increase the likelihood of a virtuous cycle of economic growth and the expansion of constitutionalism.

This suggests new lines of research into the success and failure of adopting constitutional institutions. Are transitions easier in countries with traditions of decentralized administrations



where administrators were deterred from resolving conflicts through the use of force (Greif 2005)? The histories of Japan and England illustrate that this may be the case. Both had decentralized administrations that facilitated change of elites through relatively bloodless revolutions, after which economically successful policies were implemented. At the same time, their experiences also suggest that the details of cultural heritage implied by past administrations matter. Transitions to democracy in England and Japan were gradual, but in Japan a military dictatorship rose to power after it began. Does this reflect the cultural heritage of a militarily decentralized administration as opposed to business-minded English administrators?

An even more general question is whether decentralized administrative structures or structures with similar implications make modern constitutional institutions, like their pre-modern predecessors, equilibrium outcomes. Indeed, a superficial comparison between Venice and the US, two of the most successful republics in the past and present, suggests that decentralization may still be important. Venice had many administrative committees with overlapping responsibilities and hence mutual monitoring but no centralized administration. Committee members were selected through a process that combined randomization and deliberation, were frequently changed, and were subject to auditing. This was a highly decentralized structure, relatively immune to capture, without powerful administrators and in which political rent benefitted many.

The equilibrium underpinnings of constitutionalism in the present nevertheless may rely more on decentralized legal administrations than on the decentralized financial and military administrations of the past. A transition may well have transpired in 17th century England. The House of Commons established a way to constrain the Crown while increasing financial and military centralization. Building on precedents, in 1681 it announced that it has the right to initiate impeachment proceedings against any officials who failed to follow the Parliament's laws and created a mechanism to implement this (*House of Commons Journal*, 26 March 1681). Hence, the Parliament could hold any official who followed an illegal order by the Crown personally liable.<sup>40</sup>

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<sup>40</sup> Indeed, while there were only 49 impeachments in the 337 years since the first in 1283, there were 148 cases from 1620 to 1720. (Calculated from Simpson 1916.) Among those impeached were such dignitaries as a Privy Councillor (1679), High Chancellor of Ireland (1695), and the Commander of the Royal Navy (1701). (Ibid and

The administrative structure in the US seems to be similarly highly decentralized, relatively immune to capture and without powerful administrators (although less so than previously). Much of the military, financial and other administrative aspects of the Federal government are provided by the states (e.g., the national guard), independent administrative bodies within them (e.g., school districts), business associations (that regulate their industry) and even individual corporations (e.g., business corporations that collect taxes and provide information about financial transactions). Even when what was good for GM was good for America – and GM was probably the largest tax collector in the US – it could not be captured or acquire administrative power (although it gained political influence).

The political economy of implementation also brings up new questions regarding the challenge of adopting constitutional institutions. Did the administrative structure that remained in various colonies improve their ability to sustain constitutional institutions? Did indigenous experience in constitutional institutions matter? Are administrative structures strategically manipulated to perpetuate the control of a particular elite? Is the ineffectiveness of the administration in many developing countries a way to prevent powerful administrators from constraining the ruler?

More generally, in Europe the development of constitutional institutions was gradual. It transpired in the context of having legitimate rulers and political representatives with administrative power. New post-colonial states were often supposed to become constitutional overnight, without legitimate leadership and representative assemblies with administrative power. Therefore, it may well be that administrative reform is a missing key ingredient in institutional reforms aimed at fostering liberal democracy. Current administrative reform focuses on the important task of making administrations more effective. What is also needed, however, are reforms aimed at distributing administrative power in support of liberal democracy. The problem, of course, is that of implementation.

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Fryde, et. al., 1986.) The impact of impeachment laws depends on belief. If each official expects that sufficiently many others will follow the law, impeachment is effective against the few who break it. If each expects others to break the law and follow the Crown's orders, impeachment is not effective. By the end of the 17th century, however, the long tradition of the rule of law may well have rendered the first equilibrium a focal point.

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