

Why Developing Countries Prove So Resistant to the Rule of Law¹

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I. Introduction

Why do developing countries prove so resistant to the rule of law? The problem is all the more paradoxical because the institutional technologies for providing the rule of law – systems of property rights, civil rights, and personal liberties, general incorporation laws, corporate governance structures, contract law, and judicial systems – is relatively well-known. To address these questions, I draw on the new approach developed by North, Wallis, and Weingast (2008) – NWW – to suggest how the rule of law emerged in the West and then

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use this framework to show why the rule of law cannot readily be transplanted into developing countries.

The traditional approach to development in economics, political science, and law sees developing societies as incomplete version of developed ones; that is, as lacking essential ingredients of mature developed societies. Economists, democrats, and legal scholars all recommend that new institutions and policies be transplanted from developed societies into developing ones – typically capital, technology and competitive markets; parties and elections; and rights, constitutions, and judicial institutions. And yet these reforms rarely succeed in producing long-term economic growth, stable democracy that polices public officials, and rule of law institutions with efficient justice.

The NWW approach provides a new explanation for why it is so difficult to transplant these institutions from developed societies into developing ones. This framework divides today's societies into two different types of social orders, arguing that developing countries differ dramatically in their social organization from those of developed ones. Missing from traditional approaches is how societies reduce or control the problem of violence. The most common social order throughout history, the limited access order or natural state, solves the problem of violence through rent-creation, granting powerful individuals and groups valuable rights and privileges so that they have incentives to cooperate rather than fight. Rents, limits on competition, and limited access to organizations hinder long-term economic development of these societies. In contrast, open access orders use competition and open access to organizations to control violence and are characterized by rent-erosion and long-term economic growth.

I focus on two aspects of the rule of law in this paper: first, the ideas of certainty, equality before the law, and the absence of arbitrary abuse by authority; and second, a dynamic component missing from most treatments that requires that the rule of law hold today, but also tomorrow. The dynamic issue raises the problem of turnover in the ruler or dominant coalition of a state: what binds the one to today's rules? This issue is especially problematic in authoritarian regimes but is relevant in all natural states: the inability to bind successor regimes to today's rules and institutions is a fundamental barrier to establishing the rule of law in natural states. No matter how attractive are today's institutions or the rights, they are no good in the long-term if tomorrow's regime can alter them at will. As I emphasize below, this question intimately tied to the issue of creating a perpetually lived state, a state where not only are today's officials bound by the rules but so too are tomorrow's.

Too often, students of the rule of law focus on the form of rights – for example, the nature and specification of the law – or the form of institutions – for example, the nature and specification of judicial institutions – that should implement and oversee those rights. They fail to study how to sustain these institutions and protect them from abuse by political overseers. Natural state leaders typically have the power to undo these institutions when they prove inconvenient, as witnessed by Nazi Germany's Adolf Hitler, Russia's Vladimir Putin, or Venezuela's Hugo Chavez. Similarly, many natural states have leaders who taken power by force, and these leaders often directly compromise existing institutions; examples include Chile's Augustin Pinochet and Spain's Francisco Franco. Finally, many natural states fall into Civil War, which also ends continuity of institutions, as illustrated by the former Yugoslavia in the early 1990s or Rwanda in 1994.

The main lesson for this paper's question is that creating the rule of law requires more than that natural states adopt the institutions and governance structures possessed by open access orders. It instead involves the far more difficult task of the transition from the natural state to an open access order. Just as we cannot transplant open access, competitive markets

into natural states, we cannot transplant rule of law institutions into them. To gain the rule of law, natural states must begin to transition into open access orders. Rule of law emerges as part of this transition when the society evolves from a basis in personal relations and exchange to one based on impersonal relations and exchange. Part of the transition is institutional. Indeed, creating the rule of law requires two separate institutional changes: Institutions to provide for the law; and a set of credible commitments that protect those institutions and ensure that they survive.

This paper proceeds as follows. Section 2 sketches the North, Wallis and Weingast framework. Section 3 defines the aspects of the rule of law used in this study. Section 4 applies this framework to the emergence of rule of law in a historical perspective, showing its intimate connection to the transition and how the societies of the West grappled with these issues as they made the transition from natural states to open access orders. Section 5 explains why the procedures, rights, and institutions of the rule of law cannot simply be transplanted into developing countries. My conclusions follow.

II. The Conceptual Framework for Interpreting Recorded Human History

To understand how societies are organized and function, I rely the conceptual framework developed by North, Wallis, and Weingast (2008).¹ The NWW framework distinguishes among *social orders*, distinct patterns of organizing society. The social order represents the pattern of human relationships structured in a way to constrain violence. The method by which a society constrains violence affects the entire society. The concept of a social order provides a framework within which we can understand how the political, economic, and other systems relate to one another. As we will see, the framework integrates fundamental concepts: violence, institutions, organizations, and beliefs. Central to the framework are the questions of how and whether violence is controlled or contained; how are societies organized and what institutions support them; in particular, how they support organizations and who gets to form organizations; and finally, are interactions based on personal or impersonal relationships?

Human history has witnessed three social orders. In the *foraging order*, which reaches back long before recorded human history, people existed in small bands, typically of 25 to 100. We will rarely be concerned with this social order. The *limited access order*, also called the natural state, emerged with recorded human history about 10,000 years ago. In this social order, the political system manipulates the economic system to create rents so as to control violence and sustain order. By allocating the rents to those with violence potential, these societies significantly reduce the problem of violence. Finally, the *open access order* relies on competition in the political and economic systems to sustain order.

¹North, Wallis, Webb, and Weingast (2007) elaborate some of the implications of the framework for the problems of economic development.

II. 1. Persons and Personhood

Relationships in natural states are personal relations; specifically, relationships among members of the dominant coalition are personal: they depend on the identities of the individuals. How the state treats an individual – his rights, privileges, rents, and duties – depend on his individual identity, and these rights, privileges, rents, and duties differ across individuals. Similarly, relationships along patronage hierarchies are personal. These states build on repeat play interaction among individuals to help build personal knowledge and trust and to enforce exchange. Because everyone and every relationship is different, repeated interaction is necessary to enforce exchange. Cooperation and exchange break down when these relationships are infrequent.

A person has two parts. First, there is the physical embodiment of the person. Every human, for example, possesses a unique corporeal body, including size, appearance, and intelligence. Second, every person has a set of socially ascribed characteristics based on their position, power, privileges, rights, and duties. Moreover, the law may endow non-corporeal persons, such as organizations, with personhood so that they have legal standing under the law. A legal person is an entity capable of bearing rights and duties. Western law since the Romans has recognized legal persons as combinations of both sets of attributes.

A society is dominated by personal relationships when each individual's social persona is unique. In contrast, a society is dominated by impersonal relationships when the social persona of large classes of individuals are the same.

II. 2. The Natural State

All states must control the fundamental problem of violence. Natural states do so by creating a dominant coalition of the powerful. The coalition grants members privileges, creates rents through limited access to valuable resources and organizations, and then uses the rents to sustain order. Because fighting reduces their rents, coalition members have incentives not to fight so as to maintain their rents. Natural states necessarily limit access to organizations and to restrict competition in all systems. Failing to do so dissipates rents and therefore the incentives not to fight.

We call this order the *natural state* because for nearly all of the last 10,000 years of history – indeed, until just the last two centuries – the natural state was the only solution to the problem of violence that produced a hierarchical society with significant wealth. In comparison with the previous foraging order, natural states produced impressive economic growth, and even today we can see the impressive wealth amassed by many of the early civilizations. In contrast to open access orders, however, natural states have significant, negative consequences for economic growth.

Personal relationships characterize both politics and economics in natural states. Within the dominant coalition, all relationships are personal. More powerful members, for example, gain more valuable privileges. Natural states that fail to distribute benefits in this way risk violence. When the power relationships are out of balance with the distribution of benefits, those with more power than benefits are tempted to demand a larger share; and, if it is not forthcoming, they are then tempted to fight for it. Patronage networks typically connect those with less power to those with the most power: anyone without power must be connected to an organization with power in the event that violence breaks out. Personal

relationships also characterize most economic relationships. The principal mode of enforcing economic exchange is repeat play. Rule of law institutions, such as courts, only begin to emerge in mature natural state, and these are largely for organizations rather than individuals.

Natural states are stable, but not static. They regularly adjust as circumstances change. Dramatic weather events, changes in demographics, changes in relative prices, technological change, military events, and so on all have implications for the fortunes of coalition members. As some members become more powerful and others weaker, the coalition must adjust the distribution of benefits and rents. Failing to do so risks violence as those members whose rents, privileges, and rights do not match their power threaten violence to gain what they believe is their fair share. Natural states therefore regularly have dramatic adjustments in rights and privileges, often expropriating the assets and privileges of some elites and granting them to others.

II. 3. A Typology of Natural States

The NWW framework distinguishes among three types of natural states, depending on how they treat organizations and, in parallel, their institutional sophistication. In *fragile natural states*, the only organization is the state itself, the dominant coalition. These states have little differentiation and hence little economic specialization and exchange. Fragile natural states are poor and prone to violence, and they have a limited range of institutions and credible commitments. Examples include Chad, Iraq, Mozambique, the Sudan, and most recently, Kenya.

In *basic natural states*, a set of organizations exists, all closely associated with the state. These organizations create considerable specialization, such as tax collection, religious activity, and specialized economic functions, including mineral extraction or long distance trade. Basic natural states have a wider range of institutions to support state organizations, and they are more resilient to shocks than fragile natural states. These states may also have a range of public institutions, such as succession rules for new leaders, rules that regularize taxation rates or the division of spoils from conquest. To the extent that these states have enterprises, they are state run enterprises. All of these issues hold the potential for violent disputes, and rules that institutionalize decisions about them reduce the chances of violence. Examples of basic natural states include the Medieval Carolingian empire, the Aztec Empire, and the former Soviet Union.

Finally, *mature natural states* develop sophisticated private organizations that exist apart from the state. Merchant organizations and other private firms may exist independently of the state rather than being state run enterprises. In parallel with private organizations is a system of private law and contract enforcement that supports these organizations. Nonetheless, mature natural states limit access to private firms as part of the rent-creation process. Only elite members of the dominant coalition have access to private organizations, and this access remains a valuable privilege. Mature natural states are more resilient to changing circumstances than are basic natural states; as with all natural states, however, they too have crises and periodic coalition adjustments of rights and privileges. Examples include 17th century England and modern day Argentina, Brazil, Mexico, and India.

Moving across the progression of natural states, from fragile to basic to mature, states become wealthier. These natural states become wealthier for several reasons. First, the range of organizations and the degree of specialization and exchange is richer across this progression. Second, the degree of violence diminishes across the progression. Lower levels

of violence has a direct effect and an indirect effect on wealth. Directly, less violence destroys less wealth. Indirectly, lower levels of violence mean that greater numbers of potentially profitable exchanges take place because parties that would lose if violence broke out become willing to make the exchange when the risk of violence diminishes.

Nonetheless, the need of all natural states to use limited access to control violence necessary limits access to rights, to organizations, and hence to competition in the economy. This is why they are also called limited access orders. It also limits competition in the polity, limiting competition for ideas and means of solving various political and other dilemmas that all societies inevitably face.

II. 4. Open Access Orders

Open access orders sustain open entry to political and economic organizations. As a result, they exhibit political and economic competition, and this competition supports order and prevents violence. In contrast to the natural state, all citizens have the ability to form contractual organizations and to use the state's courts to enforce the organization's contracts. Open access also creates and sustains a rich civil society. Competition and open access in each system reinforces competition and open access in the other.

Standard views in both economics and political science fail to understand the open access order because they typically focus on one system alone. Economists attempt to understand economic stability by focusing on the equilibrium properties of markets without reference to the political system, ignoring the problem that property rights, the legal system and contract enforcement, and macroeconomic stability are all products of political and democratic choices. Political scientists study the properties of a democratic systems in open access orders taking them as given, failing to explain both how democracy sustains competitive markets and how democracy is sustained when it fails in most countries.²

Open access orders are sustained in part by a belief system that emphasizes equality and incorporation. In the 19th century, these beliefs were embodied by incorporating citizens within the law, markets, and democracy where elites had previously excluded them. In the 20th century, these beliefs encompass more and now include impersonal equality before the law so that the rule of law is enforced impartially for all citizens. Further, these beliefs have actualizations in wide range of policies and public goods that create explicit sharing: public goods (such as education), social insurance (such as health, unemployment, old age, and workers' accident insurance), and the provision of infrastructure (such as access to a wide range of local public goods). Although not all people living within the society's borders need be citizens for open access to be sustained, a large portion must be. Nonetheless, to be an open access order, all citizens must be equal; that is, the state must treat them impersonally.

Equality, incorporation of citizenship, and policies for sharing all lower the demand for crippling redistribution that might destroy an open access order. This observation parallels the argument that all successful constitutions limit the stakes of power (Weingast 2006). Because powerful groups are less likely to be threatened by incumbent regimes, constitutions that limit the stakes are subject to fewer coups as these groups support coups to protect themselves.

²Most new democracies fail. To the extent that open access orders can sustain stable democracy, something must be different about them. Yet the literature fails to provide a compelling case for why. See Weingast (2006) for details.

Open access orders sustain political competition in the form of competitive party systems. The success of this competition depends on open access not only to parties but to organizations more generally. Open access to organizations, in turn, fosters the civil society, allowing citizens to mobilize and defend their interests when threatened. Organizations of all types – benevolence societies, churches, soccer leagues, firms – are potential political tools for mobilizing interests in the face of political threats. Political parties not only organize the electorate, they police one another. The political opposition is central to a successful democracy. Not only does the opposition formulate alternative plans, but the threat of the opposition forces incumbents to adapt their own policies in the face of new circumstances. This dynamic competition of ideas and policies affords open access orders a degree of adaptive efficiency (North 2005) not possessed by natural states.

Open access orders also sustain competitive markets. These societies therefore produce long-term economic growth. Competitive markets have strong feedback mechanisms that limit the ability of political systems in open access orders to create too many rents. Market competition erodes many rents. Fiscal interests imposes costs on governments that impose too many rents: a massive program to create rents that imposes significant harms on the economy has immediate feedback: a shrinking economy means lower tax revenues to support redistribution; and a shrinking economy directly harms voters. Both of these effects have historically turned voters against incumbents in stable democracies. Mobile resources and international competition reinforce these effects.

A final aspect to observe about open access orders has been the growth of government. Following beliefs in equality and inclusion, policies for social insurance have meant substantial increases in government spending to finance these programs. Underlying these programs is the ability of open access orders to provide benefits to impersonal categories of citizens. Because natural states lack the ability to treat citizens impersonally, they face great difficulties in providing public goods. Similarly, inclusion in open access orders leads to the provision infrastructure in the form of wide range local public goods and services (roads, electricity, telephones, water, sewage, garbage), and public education, all of which require significant expenditures. Open access orders have bigger governments than do natural states in large part because they provide more public goods and services to their citizens.

II. 5. Natural states vs Open Access Orders

Natural states have many of the same institutions as open access orders, such as parties, elections, markets, and judiciaries. Why do they work differently in open access orders? The answer is that natural states have limited access to organizations, lack competition, and lack a perpetual state.

Limited access to organizations and the creation of privilege hinders markets. While natural states may have some markets, these markets are hindered by cumbersome restrictions, far more so than in open access orders. Legal systems in these states typically fail to enforce contracts or mediate disputes among individuals and organizations based on rule of law principles. Indeed, most natural state judiciaries are just another form of corrupt rent-generating organizations. Finally, the absence of a perpetual state means that the state itself hinders markets with arbitrary action. As Haber et al (2008) illustrates for Mexico, the government regularly grants extensive privileges and monopoly privileges in banking, only to expropriate the banks during times of crises and then repeat the cycle anew. The inability of

the state to commitment to honor a stable system of property rights greatly compromises markets in natural states.

Similarly, many mature natural states hold elections, some for decades (as in Mexico since 1930 or Chile prior to 1973). But here too, elections differ systematically from those in open access orders. As mentioned, the incumbents may compromise the opposition's ability to compete in various ways. Limited access to organizations hinders the civil society, compromising the ability of citizens to express their views. The absence of a judicial system that operates under rule of law fundamentally transforms the legislature in these countries. This absence makes it difficult for the legislature to pass laws controlling the bureaucracy, for there is no way to enforce the laws. This allows executive dominance of the government, greatly diminishing the separation of powers and the ability of the legislative branch to act as a check on executive power.

Another problem with natural states is the inability to provide benefits on an impersonal basis. This hinders their ability to provide public goods, making it much more difficult to provide the most common policies of open access orders that complement markets: the public goods of social insurance, education, and infrastructure noted above.

Finally consider dynamic stability, how natural states differ from open access orders in their response to shocks. All states face problems and crises. How do they respond? First, because open access orders have better means of controlling violence, violence is far less likely to break out when a crisis occurs. Citizens are therefore much less likely to respond by protecting themselves. In contrast, where violence is likely or a possibility, citizens or groups may well respond quickly to violence to protect themselves so as not be vulnerable if the other side initiates violence. This dynamic means the potential for violence makes these societies volatile.

Second, open access orders exhibit competition for ideas. Parties compete for solutions to crises, and the open access to organizations within the civil society means that many new ideas will be produced and debated throughout the society. Opposition parties and interest groups in particular have strong incentives to monitor, criticize, and provide alternatives to the solutions proposed by incumbents. Open access orders therefore make it far easier than natural states to discard bad or failed ideas.

Third, by virtue of being able to make credible commitments more readily, open access orders are more likely to create new pacts in the face of crises. Indeed, the history of all open access orders is replete with pacts that solve crises; to name a few: the creation of the French Fifth Republic in 1959, the Compromises of 1820, 1833, 1850, and 1877 in 19th century United States, the Glorious Revolution of 1688 and the various 19th century Reform Acts in Great Britain.

The force of this subsection is twofold. First, natural states possess many of the same institutions as open access orders, such as markets, elections, and judiciaries. But these institutions work very different in natural states because they limit access, lack a perpetual state, and cannot deliver benefits to citizens on an impersonal basis. Second, open access systems are not perfect, and in practice all open access produce significant rents. But – in comparison to natural states – open access orders competitive mechanisms work relatively well and provide a far better means for long-term economic growth and resiliency to various problems and crises faced by the society.

II. 6. The Transition From Limited to Open Access

The NWW perspective redefines the process of economic and political development as the transition from a limited access order to an open access order. The transition is a difficult process, and only two or two and a half dozen states have successfully completed it. As I use this material only sparingly, I only briefly describe the transition (see NWW, chs 5 and 6 for further details).

Because the transition begins with the natural state, the early part of the transition must be consistent with the logic of the natural state. Some natural states move into positions in which a series of changes toward open access can be sustained. Within a natural state, conditions may arise that enable impersonal relationship to develop among elites. When this occurs, elites may find it in their interests to institutionalize these relationships.

NWW divides the transition process into two parts, the doorstep conditions and the transition proper. There are three doorstep conditions:

DC 1: Rule of law for elites. Some mature natural state institutionalize relations among elites so that privileges are regularized in a way that they begin to become transformed into rights; put another way, privileges move from being personal and idiosyncratic to being impersonally applied equally to all elites. As discussed below in greater detail, English medieval land law provides an illustration. In the 11th century, rights to land reverted back to the king on the death of the lord. For a negotiated payment – depending on both the value of the land and on the expected relative power of the heir – the heir could purchase the rights to the land. Over time, this process became standardized and impersonalized in fees. Similarly, competition among different court systems in England for revenues led courts to innovate, leading to rules that better served elite interests. Importantly, legal rules emerged granting landowners the right to control how land passed among various heirs when they died, including the ability to grant rights to land on conditions (whereby if the conditions failed, the land reverted to another heir).³

DC 2: Creating the perpetual state. Almost all natural states are mortal in the sense that, as the dominant coalition and rulers change, so too do fundamental aspects of the state. These states have little ability to make credible commitments to honor various rights and rules that bind successor coalitions and leaders, so that new leaders often make dramatic revisions in the nature of institutions, rights, and policies. The idea of perpetuity is to create aspects of the state that live beyond the lives of the current officeholders so that the institutions do not depend upon the identity of the officials that hold them.

An especially important aspect of perpetuity is the creation of perpetually lived organizations, organizations whose existence extends beyond the lives of the individuals that create them. Partnerships, the dominant form of business organization throughout history until the mid-19th century, requires that the organization be dissolved or reorganized on the death or voluntary leaving of one of the partners. Creating corporations with tradable shares and allowing the shareholders to pass their shares to heirs upon their deaths solves this problem, creating perpetually lived organizations. Corporations therefore allow far great risk pooling and have much longer time horizons than partnerships.

³These issues are quite complicated, both in terms of the various forms of rights (breaking property into different groups; placing different conditions on different pieces of property); different forms of legal rules; and so on. See NWW (ch 3).

DC 3: Consolidated control over the military. The third doorstep condition is at once the most difficult to understand and to achieve. Without consolidated, political control over the military, neither of the other doorstep conditions matter much. As long as one faction can use military power to force others to their will, there can be no rule of law or credible commitments. And yet, we know too little about how this consolidation takes place (NWW, ch 5).

The Transition. The transition proper occurs when sufficient numbers of people become citizens in the sense that the state treats a large category of people impersonally and identically. At the same time, processes must begin that afford citizens access to organizations in both politics and economics, granting them the ability to compete as they wish in either system. In the United States, this process occurred over several generations, spanning the colonial era through the Constitution and well into the 19th century. Indeed, the idea of party competition with a legitimate opposition party in politics did not emerge until the middle of the 19th century, around the 1840s (Hofstadter 1969; NWW, ch 6). Similarly, general incorporation laws, allowing anyone to form a corporation, also arose first in the 1840s (NWW, ch 6). Events in Great Britain were not far behind the United States; and in France, they occurred by the 1880s.

III. Vexing Problems in Creating the Rule of Law

In this section, I define the rule of law and consider vexing problems raised by the NWW framework for creating it in natural states. The rule of law means different things in different contexts and is sometimes used to encompass all good things. For the purposes of this paper, I emphasize two aspects of the rule of law; first, the impersonal aspects of law: the certainty or predictability of the law, including the absence of arbitrary actions by the state against individuals; and the ability of the state to treat individuals as citizens with equality before the law. Second, a dynamic aspect of the rule of law that requires that the state be able to honor these aspects of the rule of law tomorrow even if it experiences turnover in officials.

By this definition, natural states have substantial difficulties maintaining the rule of law. First, this definition contrasts with the typical natural state dominated by personal relationships. In natural states, an individual's identity determines how they are treated so that more powerful people are explicitly treated differently than weaker ones. For example, the state typically treats – as a matter of *de jure* or *de facto* – Duke A differently from Dukes B and C. Similarly, all Dukes are treated differently from mere knights, let alone from all peasants.

Second, natural states have difficulty creating the predictability necessary for the rule of law. Because these states are built around the dominant coalition, as the needs and power relations of the coalition change, so too do rules, policies, rights, and privileges. Similarly, the absence of perpetuity makes it very difficult for natural states to commit to long-term rules, institutions and policies.

Third, natural states often act arbitrarily; that is, policies and rights appear to be too closely associated with choices by the ruler bound not by rules but by whim. This behavior typically reflects the logic of the dominant coalition of the natural state. As the fortunes of the various coalition members rise and fall, for example, the ruler adjusts their rights, privileges,

and rents, often redistributing them from some members to others. From the open access perspective, these choices seem arbitrary.

Finally and perhaps most importantly, the rule of law involves the dynamic component, for the issue of the certainty of the law concerns not only what the law is today, but what it will be tomorrow. We take this issue for granted in open access orders, but those living in natural states cannot.⁴ The dynamic issue raises several concerns. First, from an economic and political standpoint, consider expropriation. Investors of all kinds want to know not just what the rules are today – property rights and tax rates, for example – but what they will be tomorrow. Investments profitable under today's rules may not be under tomorrow's, particularly if the government acts opportunistically. Farmers in Ghana, for example, fear that their long-term investment in coffee trees profitable under today's tax rates will be expropriated if the government raises the tax rate as the trees mature and start bearing fruit.

Second, a political complication concerns the problem of changes in the dominant coalition and ruler: natural states have too few institutions that binds new coalitions and their leaders to today's rules. This is especially problematic in authoritarian regimes. As we will see in the next section, this problem is intimately tied to the issue of creating a perpetually lived state.

The answer to both of these problems is the concept of credible commitment. States cannot simply announce impersonal rules and rights, for these rulers – or their successors – may alter them tomorrow or next year. Creating perpetuity requires institutions with two characteristics. First, these institutions must commit the state – political officials, judges, bureaucrats – to honor these rules and rights. Second, they must commit all major players in society to respect the constitutional rules. In particular, anyone with access to violence and the ability to overturn the regime must have incentives to refrain from doing so; and those in power who lose elections must also have incentives to give up power. These commitments are intimately connected with creating the perpetual state and the dynamic aspects of the rule of law over time. Unfortunately, this type of credible commitment eludes most natural states and occurs only for those that begin the transition.

IV. Historic Emergence of the Rule of Law in the West

Conceptually, the emergence of the rule of law coincides with the transition from the natural state to the open access order. Natural states have only a limited ability to provide the rule of law; they cannot make extensive credible commitments to institutions and rules that provide for certainty expectations and that treat a wide class of citizens equally. Whereas the rule of law requires that the state treat citizens impersonally, natural states treat people differentially and personally. Natural states also emphasize power; and as power shifts, not only does the membership in the dominant coalition adjust, so too do privileges, rents, institutions, and policies. These adjustments can be seen in the coalition changes in 17th England, as the Stuart Kings redistributed power and rents from one fraction to another, but also in modern natural states, such as Russia under President Putin and South Africa under

⁴This dynamic component is not always assured in open access orders. The Bush Administration's handling of suspected terrorists demonstrates that, at the margin, these rules can be compromised under when open access orders face difficult circumstances.

current President Thabo Mbeki who is increasingly shaving away on the democracy agreements made under Nelson Mandela that transformed the previous apartheid regime.

Natural states cannot sustain rights of large group of citizens who are equal under the law. Nor can today's natural state bind successor regimes. Thus, even if today's regime in a natural state institutes the appropriate reform, it cannot commit itself or its successors to maintain these reforms. Rights and reforms in natural states fail when the ruler needs to adjust the coalition in response to changing circumstances.

Natural states entering the transition, however, change as they begin to assume the doorstep conditions. All three of the doorstep conditions are central to the emergence of the rule of law. The first doorstep condition is rule of law for elites, in which various forms of elite privileges are transformed into elite rights. Consider early English medieval history.⁵ Immediately following William the Conqueror's invasion in 1066, the King dispersed rights to land to his followers from Normandy. These holdings did not displace existing landlords, but instead forced existing landlords to pay tribute to and share rents with the newcomers. At the death of these men, the rights to the land reverted to the king who might, for a payment, return land rights to the original holder's heir. But the king might also redistribute rights to the land. If, for example, the fortunes of the original holder had fallen (say the heir was seen as a weak leader) while those of another had risen (say had done favors for the king and deserved a reward), the king might grant the land to the latter instead of the former. In this way, the logic of maintaining the dominant coalition in the natural state dictated the allocation of rights to land, which worked as a system of privilege to the powerful rather than as a set of rights. England at the time was a fragile natural state; it had few organizations outside of the state.

Over time, as relationships stabilized, new institutions and organizations associated with the state grew. Although the king sought to retain his flexibility with respect to rights to use the land, the great lords had a collective interest in stabilizing the rules. Moreover, wealth would rise if rights could be made more secure; everyone, the king included, could be made better off, if rights were made more secure. And so, over a considerable period of time, rights to inherit the land became more secure.

This same scenario played out with respect to a wide variety of aspects of rights associated with land. As another example, consider the ability to devise property by will. Although heirs could inherit land in medieval England, the law did not allow the owner flexibility in terms of dividing land among many heirs or granting land under particular conditions which, if unmet, would allow the land to revert to another heir. Here too the law took several centuries to allow elites the flexible rights to devise property by will. In the end, rights to land became secure slowly over many centuries, and were considerably secure as England became a mature natural state in the 17th century and then began the doorstep conditions.

As a final example, consider the emergence of rights to sell and trade in corporation shares. Originally, corporate shares emerged as a privilege associated with a unique corporation created to capture rents associated with a particular opportunity, such as the East India Company or the Bank of England. But once a corporation was created, holders of its shares had an incentive to create the right to trade these shares and to extend the right to own them to a substantially larger group of people: doing so would enhance the value of their shares. In other words, although these corporations began as personal, natural state creations,

⁵This discussion of English medieval land rights draws on NWW (ch 3).

they provided incentives to create impersonal securities markets to enhance the value of the firms and to increase the liquidity of the owners' capital.

Each of these cases illustrates the transformation of elite privileges into elite rights. Each also involves the transformation of the state so that it creates a system that enforces these rights and hence attains aspect of rule of law for elites.

The second doorstep condition, perpetually lived state and organizations, is also central to the rule of law. Unfortunate, this critical aspect of the rule of law is largely neglected in literature in part because the literature fails to study the problem of maintaining the rule of law over time.

Put simply, *the absence of a perpetual state allows future natural state officials to dishonor the rules, laws, and institutions devised by today's state*. Perpetuity is therefore an obvious, necessary, and dynamic condition for states to maintain the rule of law. Indeed, many of the classic figures in the rule of law have articulated sentiments that fit with this logic. Where Aristotle in the *Politics* condemns rule by people rather than rule by law he seems to be referring to perpetuity. David Hume suggests the same in his *Essays* when he discussed the evolution of the English "government of will to a government of law." Similarly, Locke, in his *Second Treatise*, says, "Freedom of men under government is to have a standing rule to live by, common to every one of that society, and made by the legislative power erected in it . . . and not to be subject to the inconstant, uncertain, arbitrary will of another man." All of these ideas depend not just on the certainty of law, but on the perpetuity of the state.

Because natural state rulers, representing the dominant coalition, face few credible commitments, they can remove or undo laws and institutions that they find inconvenient. Former President Vladimir Putin systematically did this in Russia, transforming a mature natural state back toward a basic one. A range of political institutions that once stood as modest checks and balances on former Russian President, Boris Yeltsin, either no longer exist or are much weaker, including the Russian Duma, the governors, the press, and the civil society. The absence of these checks has allowed Putin to remove his political opponents and take undisputed control over Russia, even as he has nominally stepped down from the presidency and allowed a successor, Dmitry Medvedev, to be elected to that office. A wide range of once independent private organizations have lost their independence so that only organizations with a close association to the government can now survive. Because these institutions lacked perpetuity, they could be dismantled. President Hugo Chavez of Venezuela has overseen a similar if less thorough transformation in Venezuela. In the 1930s, Adolf Hitler engineered a similar if far more sinister transformation of the Weimar regime into Nazi Germany. These leaders accomplish their goals in response to changing circumstances, such as a depression or a significant increase in state revenue, that allow them to consolidate their position by eliminating privileges of other coalition members whose support is no longer needed to survive.

Creating perpetuity requires establishing a form of credible commitment by which the ruler and dominant coalition have incentives to honor the institutions and rights protected by the credible commitment. The incentives created by the credible commitments imply that the institutions and rights do not depend on the identity of the ruler, other political officials, or members of the dominant coalition. As the rulers, political officials, or coalitions change, state institutions and citizen rights nonetheless survive and elements of the rule of law can be sustained.

As it is the most novel aspect of the rule of law, I give several illustrations of this concept. First, consider the creation of a perpetual state among one of the first movers, England, in the Glorious Revolution of 1688-89. This revolution was not only a coup removing one king and inviting in another, but also a constitutional revision by which the erstwhile divided English elite settled their differences over which they had fought for much of this century (including a bitter Civil War in the 1640s, the beheading of the King in 1649, the formation of a republic that failed, followed by the restoration of the monarchy in 1660). The divided elite settled many of their differences in a way that placed bounds on the powers that the king, as head of the dominant coalition, could exercise. In particular, the status of laws of Parliament and Parliament's control over taxation – both contested issues during the previous century – became sacrosanct. The portion of the Glorious Revolution known as the Revenue Settlement announced that any king who ignored a law of Parliament risked a coup (Jones 1972, p. 318, North and Weingast 1989). The new consensus created the credible commitment binding the king to the new rules.

Backed by a threat of an elite united against the crown, the Revolution Settlement created an element of a perpetual state. Laws of Parliament now bound both the current king and, equally, all future ones. The parliamentarians negotiating the Revolution Settlement were backward-looking, attempting to solve the problems of the previous century. But by endowing the state with perpetuity, they had immense forward-looking effects.

The effects of perpetuity are readily seen in three important illustrations. First consider the issue of sovereign debt. Prior to the Glorious Revolution, sovereign debt remained a personal exchange with the king, who chose whether to pay back creditors. If he wanted to lower the interest rate, delay payment, or default on the loan altogether, it was at his personal discretion. As a consequence, the king was credit-rationed; he could only borrow limited funds. After the Glorious Revolution, new debt issues became laws of parliament. Legally, this meant that altering the terms of debt required a new law of Parliament. If the king unilaterally sought to alter the debt terms, such as default on an interest payment, he would violate a law of Parliament and therefore risk a coup. Because the new arrangements greatly raised the cost to the king of altering the debt terms, the king had strong incentives to honor them. As a consequence, the credit available to the government went up enormously. Debt rose by nearly an order of magnitude in a few short years (1689-97), from roughly five percent of estimated GNP to roughly forty percent (North and Weingast 1989). This debt allowed England to hold off France in the war that began with the Glorious Revolution, preventing (among other things) France from restoring the deposed King back on the throne.

Second, perhaps most central for the rule of law concerns the independent judiciary. This independence is one of the most difficult institutions for today's natural states to accomplish. Although many developing countries announce independent judiciaries in their constitutions, few can sustain them, and most developing countries compromise their independence when it proves inconvenient. Indeed, the 17th century Stuart kings had long openly fired judges for ruling against them – famously, Chief Justices Coke (1616-7) and Crew (1627) (see Hirst 1986). The Crown was personally responsible for the day-to-day operation of the government, so it paid the judges. As they served at the crown's pleasure, the Stuart kings used their power to influence the judges' decisions. In the end, this threat produced compliant judges. Following the Glorious Revolution, judges became more independent of the crown. In 1701, Parliament passed the Act of Settlement, granting judges official independence of the crown. Here too perpetuity protected judicial independence. Parliament, as representatives of the dominant coalition, sought to protect judges by passing a law officially recognizing the independence of judges from the crown. Royal manipulation of judges now risked violating a law of Parliament and hence the threat of a coup, making

judges far more independent. Using event-study methods, Klermen and Mahoney (2005) provide statistical evidence demonstrating the importance of this Act.

Third, an important implication of a perpetual state is that it can create perpetually lived organizations. These organizations greatly increase the amount of wealth that the society can generate. For example, perpetuity allows insurance companies to pool vast quantities of risk and thus substantially reduce risk to individuals and firms. It allows corporations to pool capital and create organizations that make long-term investments that live beyond the lives of the existing partners. Because partnerships that must be renegotiated on the death of any partner, they become very cumbersome as they begin to pool large amounts of capital from larger numbers of members.

More generally, perpetuity is central to the process of creating a long-term time horizon for a society. As is well-known, short time horizons lead to bad decisions by state leaders (North 1981, ch 3, Bates 1983, Olson 1993). The absence of long-term horizons greatly hinders the ability to make long-term investments, which are critical to long-term economic development. Put simply, investors cannot have long time horizons and make long-term investments if the state is not perpetual and has a short time horizon. The absence of a perpetually lived state therefore implies the absence of perpetually lived organizations.

Creating perpetuity is therefore a central feature of the rule of law. It is a necessary component of creating a state that moves beyond the personal rule of individuals, where the institutions and policies of the natural states depend upon the identity of the dominant coalition and who runs the state. Creating perpetuity requires credible commitments that institutionalize political and social mechanisms that create incentives for both political officials and citizens to honor the rules so that not only do today's officials honor the rules but so too will tomorrow's. This is clearly part of the essence of satisfying the two conditions of the definition of the rule of law articulated in section 3.

The third doorstep condition, consolidated control over the military, is another obvious precondition for the rule of law. Indeed, as NWW (ch 5) argue, the other two doorstep conditions cannot be sustained if this condition is not firmly in place. The absence of consolidated control over the military allows those with access to military resources to grab what they like, if not always when they like, at least when circumstances are propitious. As long as this type of military intervention remains possible, the rule of law cannot hold. Strongmen with access to violence have the ability to evade the law, so the rule of law necessarily remains incomplete. Although perhaps the most important of the three conditions, we know least about this doorstep condition.

Conclusions. The emergence of the rule of law is intimately connected with the transition from natural state to open access order. Each of the three doorstep conditions involves the rule of law. Natural states have great difficulties establishing and maintaining institutions capable of sustaining the rule of law. They cannot deliver benefits on an impersonal basis. The absence of perpetuity means that they cannot commit to long-term policies, so that these states witness great transformations in institutions and policies, whether following dramatic coups, such as Chile (1973), the severe financial crises of Argentina (2001) and Thailand (1997), or the more subtle and prolonged transformations of present day Russia, Zimbabwe, Kenya, and South Africa. Each of these natural state transformations reflects the absence of perpetuity, allowing leaders to adjust institutions, policies, rents, and privileges as the needs of the dominant coalition change in order to maintain political stability (or, sometimes, a mere modicum of political stability in the face of threats of more severe

disorder). Frequently accompanied by dramatic policy reversals, these shifts wreak havoc with investment and the economy; they may also end freedoms overnight, such as democracy. All too frequently, the institutions designed to promote the rule of law are a casualty.

V. Why the Rules, Rights, and Institutions Supporting the Rule of Law in the West Cannot be Transplanted into Developing Countries

Natural state systems of privilege and rent-creation do not arise simply because people are greedy. Instead, privilege and rent-creation arise because they are the solution to the problem of violence. Rents grant powerful individuals and groups with access to violence incentives to cooperate with other members of the dominant coalition. In comparison with disorder, all members of the society benefit from the peace that follows.

Into this world come reformers with the best of intentions – economists promoting economic reform, democrats promoting elections and democracy, and lawyers promoting legal reform and the specification of citizen rights. These reformers argue that their proposed reforms will make citizens better off. But they are wrong. The reason is that their reforms arise from the world of open access orders; they seek to transplant a subset of open access institutions into natural states without understanding why natural states systematically differ from open access orders, in particular, why natural states fail to be open access orders.

These reforms virtually always fail for two reasons: violence and the absence of perpetuity. I consider these problems in turn.

V. 1. Reform Efforts Typically Fail to Understand the Role of Violence in Structuring the Natural State

Reform efforts almost always ignore the problem of violence that the natural state political system solves. The systems of privileges and rents are not arbitrary; they serve a valuable – if costly – purpose. These institutions are the equilibrium response to the problem of violence. Dismantling these systems as part of an effort to transplant open access order institutions – such as markets, elections, and legal systems – cannot create an open access order. This has been tried hundreds of times, and it rarely succeeds. Indeed, dismantling these systems threatens violence. Consider the problem of market reform. Existing market privileges are part of the larger system of privileges and elite rights granting elites incentives to refrain from violence. Market reform that promotes open entry erodes these rents and removes the incentives that provide elite cooperation. The likelihood of violence rises, particularly in times of crisis. Similar effects arise from electoral reform that increases political competition and legal reform that grants great citizen rights.

Because these reforms threaten a society with violence, people in these societies will resist them. The paradox is that not only will those who benefit directly from the rents fight the reforms; so too will those who are exploited by the natural state privileges. The reason is that being exploited in a peaceful society is far better than living under disorder. For this reason, none of the major open access institutions – markets, democracy or legal systems – can be directly transplanted directly into developing countries/ natural states. This is also

why, despite 100s of billions of dollars, the best intentions, and the best development advice, the World Bank, the IMF, and USAID have no success stories.

Democracy and elections serve as a major check on government in open access orders. Although many mature natural states sustain elections for significant periods – including Argentina, Brazil, Chile, India, and Venezuela – elections in these states do not seem to curb corruption, serve as a check on government abuse, protect citizen rights, or more generally foster the rule of law. Indeed, these states frequently constrain the opposition’s ability to compete, such as limits on freedom of the press, constraints on open access to organizations so that groups cannot organize in support of opposition parties or candidates they favor, or candidates that are directly hindered from competing (sometimes they are jailed).

Students of democracy are only beginning to learn what makes democracy work in open access orders. Most new democracies fail, and we have only a few clues about what makes some democracies work and most not. One condition, however, is that all successful democracies seem to reduce the stakes of political conflict. The reason can be seen in Chile in 1973, Spain in 1936, or Kenya this year. When the stakes are too high, powerful groups whose interests are threatened by legitimately elected governments provide support for coups or violent movements that destroy democracy. Democratic constitutions that limit the stakes therefore make democracy more likely to survive because they make coups and violence less likely (Weingast 2006).

This same principle applies in another way, sometimes called tragic brilliance (Diaz, Magaloni, and Weingast 2008), in which natural states engineer the delivery of a highly valued local public good, such as water, so that it depends on whether citizens support the government. Failing to support the government leads the government to cut off the citizens’ water. In this case, citizens nominally possess the freedom to participate in elections, but they cannot exercise that freedom of choice because of the government’s credible threat. In comparison with open access orders that limit the political stakes, elections work very differently in natural states with high stakes politics. Open access orders provide local public goods impersonally on the basis of citizenship, not on the basis of political support; whereas natural states use the delivery of local public goods as a means of citizen control and maintaining power. Diaz, Magaloni, and Weingast (2008) provide systematic evidence that the Institutional Revolutionary Party, known by its Spanish acronym, the PRI, used this technique in Mexico to manipulate voters to support it during its long-term dominance of Mexican politics (1930-2000). Similarly, Rodriguez (1995) and Ward (1995) showed that when the first two Mexican municipalities elected opposition mayors in 1983, their budgets fell on the order of fifty percent (at the time, Mexican municipalities received on average 80 percent of their budgets from higher level governments).

V. 2. Absence of Perpetuity

The last section raised the issue of perpetuity. Central to creating the rule of law is creating a perpetual state whose institutions, rules, and policies do not depend on the identity of current officials or dominant coalition. The problem with the developing world as natural states is that almost none have perpetual states. A great many mature natural states have constitutions that specify separation of power systems with elections, legislatures, presidents, and independent judiciaries. The problem is that these institutions fail to work as specified in the constitution or as they do in open access orders. The absence of open access to

organizations means an absence of a civil society to help police political officials. Legislatures cannot effectively police the executive without a working judiciary – no one will enforce legislative restrictions on the executive – so the corrupt judiciaries of natural states hinder the separation of powers system.

The absence of perpetuity means the absence of credible commitments that bind political officials to honor political institutions and the rights they protect. When these institutions or rights become inconvenient, political officials ignore, abuse, or rescind these rights. I have already mentioned Russia under Putin. In recent years, a host of Latin American countries – including Chavez in Venezuela and President Carlos Menem in Argentina – have defied their Supreme Courts, by directly ignoring rulings; or, in parallel with the Stuart Kings, firing judges who fail to give favorable rulings; or by simply packing the Court with compliant judges so as to obtain desired rulings.

Along with the absence of the other doorstep conditions, the absence of perpetuity in most natural states helps explain why the long history of reform over the past four decades of attempts to transplant markets, elections, and judicial institutions into a great many natural states has failed to produce thriving markets, vibrant democracies, and independent judiciaries throughout the developing world. These reforms may last for a few years, but they cannot be sustained. When the natural state reaches a crisis, they typically go by the wayside.

VI. Conclusions

The approach to the rule of law – creating certainty and equality of the law with an absence of arbitrary abuse – requires not only the supremacy of the law as traditional arguments emphasize but a dynamic component by which the law holds not only today but also in the future. This involves the concept of perpetuity. To sustain the rule of law over time, the state must become perpetually lived; that is, state institutions must live beyond those who create them so that the identities of political officials do not matter. To have this ability requires the appropriate form of credible commitments that provide political officials with the incentives to honor these institutions and the rights they protect so that turnover in officials does not affect the institutions and rights.

This perspective shows why it is so difficult to transplant the rule of law into developing countries; indeed, why developing countries often actively resist attempts to secure the rule of law. A major problem with most natural states is that they lack perpetuity. Natural states solve the problem of violence by granting powerful members privileges and rents. These states adjust to changing circumstances by adjusting the distribution of privileges. Big changes in circumstances, for example, following crises, often require big adjustments in privileges, institutions, and policies. These adjustments are often accompanied by violence or threats of violence. Governments fall, coups occur, rights are altered, assets expropriated, new constitutions are written, and policies are altered overnight. The absence of perpetuity makes it difficult for these states to sustain many rights and institutions.

Even when natural states adopt all the right constitutional provisions of democracy, separation of powers, and the specification of individual rights, they cannot create a perpetual state so they cannot guarantee that any of these provisions will hold in the future, let alone over the long-term. The problem with most reforms is that they attempt to transplant the rules, rights, and institutions from open access orders directly into natural states, and these

attempts nearly always fail. When natural states face crises, they inevitably go through dramatic transformations that revise institutions, rules, and policies, making it difficult to sustain the rule of law.

The tenor of this paper is thus a pessimistic one. It suggests that creating the rule of law involves the transition from limited to open access order which has proven quite difficult. Although natural states have existed for 10,000 years, only a little over two dozen states have succeeded in this transformation, with most clustered in Europe.

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