INTERNATIONAL CENTRE FOR ECONOMIC RESEARCH

ICER

WORKING PAPER SERIES

Enrico Colombatto

SOCIAL CONTRACTS AND HISTORICAL RULES

Working Paper No.05/2009

Social Contracts and Historical Rules

Enrico Colombatto
University of Turin and ICER

April 2009

Abstract

The public choice-school has explained why policy-making is generally disappointing and frequently against the very interest of the public at large. The economics profession has put forward two kinds of allegedly free-market remedies. On the one hand, the mainstream view underscores the need for more expert advice and better agency rules. On the other, the constitutional standpoint emphasizes the role of meta-rules founded on a social contract, so that abuse can be restrained, if not eliminated.

This paper questions the foundations of the new contractarian views, which hardly escape the consequentialist and utilitarian problems raised by the orthodox approach to policy-making. In particular, it is argued that in order to understand the nature of today's policy-making, rational constructivism is of little help; competing explanations, such as those offered by the institutional or the evolutionary schools, are similarly ineffective.

The insufficiencies of the mainstream approaches suggest an alternative. We develop the idea that "First Principles" – that is those set of ideas that have characterized Western Civilization during the past two millennia – provide a better lens for understanding the role and characteristics of policy-making.

This paper is part of a broader research project on the methodological foundations of policy-making. I am extremely grateful to the Hoover Institution (Stanford University) and to the Searle Center (Northwestern University School of Law), where I have been working as a National Fellow and a Visiting Fellow in 2008/2009 and where these pages have been written. I am also indebted to the Searle Center for the many insightful comments I received on the occasion of my presentation at their Faculty Workshop.

1. On the making, credibility and stability of norms

This is an imperfect world. Democracies frequently suffer from bad norms promulgated by short-sighted politicians, most of whom ignore what they are legislating about, but who are often prepared to give in to interest groups and please representative or noisy enough layers of the voting population. As the public choice tradition has explained by applying the rational-choice postulate to the rule-makers, this is hardly surprising. Politicians are human beings like all others and the procedures by which they are chosen do not put a premium on honesty, let alone altruism. If anything, the selection process operates in the opposite direction. Independent thinking is not a plus and occasionally even being reasonable might develop into a liability. In short, rule-makers are rationally inclined to act and legislate in order to enhance their own welfare, and to do whatever is necessary to secure the consensus, popularity and reputation required for election, re-election or appointment. In many occasions party loyalty prevails upon moral integrity and the quality of the laws is affected as a consequence.

To be fair, the outcome of the legislative process is not always counterproductive or ruinous. It does happen that norms are consistent with common sense and the interests of the community broadly understood. Still, even when one abstains from evaluating the quality of the rules, and even when funding is not a problem, nothing guarantees that the rules are applied properly. For instance, the bureaucrats frequently strive to adapt them to their own requirements and preferences. They may also find it advantageous to increase the cost the citizen must incur to qualify for protection under a given piece of legislation. It needs not be a matter of blatant crime and corruption. Sometimes it is shirking; sometimes civil servants deliberately delay, or multiply the decision-making layers in order to avoid responsibility; sometimes it is just an effort to enhance the bureaucrat's own discretion in accordance with man's natural longing for prestige and power, or to create additional demand for the bureaucrat's services, which justifies his job and possibly breeds chances for career advancement[1].

The judiciary can also be a source of uncertainty, whenever the actors adhere to their own reading of what legal rules actually mean, or to their own convictions on how

[1] Revolving-door mechanisms might also play an important role. The more complicated the regulation and the greater the importance of establishing personal stable relations with the civil service, the greater the opportunities in the private sector for those bureaucrats who want to switch to the other side and become an intermediary between the private sector and their former colleagues.

to adapt them to specific circumstances[2]. Given that most cases can be branded as 'specific', the application of the same rule can easily generate different outcomes and thereby undermine its credibility, that is its ability to provide clear and consistent indication about what is legal (or illegal), and precise enough predictions about people's behavior. This phenomenon is compounded by the fact that more and more legislation results from political log-rolling and compromise, thereby leading to hazy texts, possibly characterized by loopholes and inconsistencies. Not surprisingly, they create ample scope (and need) for interpretation, and might also be the terrain where the judiciary and the legislative collude or come to blows.

The large number of regulation that the legislative and regulatory bodies pass every year does not help, either. This phenomenon is even more evident when the activities of international and supra-national agencies are taken into account, requiring adjustment by the national legislation, a task which is far from easy, quick or flawless. The judiciary usually tries to solve these inconsistencies by interpreting the original intent of the legislator, or by referring to some higher notion (e.g. constitutional super-laws), or by making use of general principles, more or less vaguely defined. Social justice, fairness and equality are well known examples of such principles. The bureaucrats also play a role in cutting through the hundreds of thousands of pages of new legislation that an advanced country with a reasonably 'productive' rule-making apparatus creates every year, although in such cases informal rules of conduct might prevail, as each office/agency tends to develop its own routines and codes of conduct.

Whatever the outcome, the bottom line is that contradictions and all but insurmountable complexities are inevitable. They create room for discretionary clarification and ironically demand for further legislation. In the end, credibility suffers and potentially counterproductive effects result. Sadly enough, while technological progress makes exchange with private counterparts in the marketplace more and more impersonal, the opposite holds true when dealing with the world of rule-making and rule enforcement.

[2] Statutes are necessarily incompletely defined and are therefore an obvious candidate for interpretation, especially when it comes to sanctions. The same is also true for precedent, although it is widely acknowledged that even in common-law countries the rules of social cooperation are dictated by statutory laws and regulations to an increasingly large extent. See for instance Harnay-Marciano (2007) for an inquiry into the motivations of the judge within a common-law system.

This increased complexity inevitably affects regulatory and legislative stability. As old rules prove ineffective or obsolete, and pressure for 'reform' rises, uncertainty about what the rule might be prescribing in the future creeps in, exchange is discouraged by potential litigation, opportunistic behavior increases and the agents' time horizon shortens. Not only does uncertainty reduce the discounted value of future income streams and therefore, ceteris paribus, negatively affects individuals' welfare[3], but many agents would actually spot opportunities to engage in contracts while hoping in forthcoming reforms with retroactive enforcement (or retroactive enforcement criteria). They would bet on the conflicts that might eventually arise, and thereby contribute to sapping the coordination and perhaps the reliability of property-right structures as well.

2. Looking for constitutional solutions

All the above shows that even when the legislator means well, the traditional notion of rule of law – i.e. a system of credible, consistent and stable coercive rules that people acknowledge as fair and effective[4] – rests on fairly shaky ground. Nonetheless, a large part of the economic profession believes to have found a solution.

---

[3] In a similar vein, Nicita (2007) underscores the importance of what he defines as *'ex ante* transaction costs', i.e. the costs related to the incomplete definition of property rights, which leads to litigation and discourages exchange.

[4] Following Hayek (1960), the recent literature on the importance of the rule of law actually focuses more on the features that enhance individual planning, long-term coordination among agents and behavioral predictability, rather than on the actual content of the rules. Put differently, more attention is being devoted to the procedural qualities of the rules, rather than to their foundations. Thus, justice (and the rule of law) is no longer a criterion to make sure that the individual rights are safeguarded, but that the individual is not discriminated against. The frame of reference is not a moral benchmark, but the other members of the community. For instance, many rule-of-law supporters are happy with regulation as long as it is credible, stable, simple to understand, easy to enforce and applicable to everybody engaging in given activities. Whether the rule is good or bad seems to have a lesser impact on the rule-of-law label. The same applies to the rather ambiguous definitions of 'everybody' and of 'given activities'.

In the end, consequentialism prevails. Prominent advocates of the rule-of-law approach to economic performance (growth) do emphasize the importance of securing private property rights and individual freedom (which is not necessarily equivalent to freedom from coercion). Nonetheless, both goals remain subject to important qualifications. As a result, the main issues of substance are entrusted to popular opinion and current moral standards, thereby short-circuiting the exploration of whether justice and legitimacy should refer to general and everlasting principles, or to mere consensus.

Following the Ordoliberal tradition[5], most economists tend to take it for granted that the recipes for economic prosperity and happiness are known: a mix of economic freedom (more or less rigorous enforcement of private property rights[6]), redistribution for the sake of social fairness and tranquility, plus variable amounts of regulation, in accordance with the proponents' convictions about the extent and relevance of the so-called market failures. In particular, two possibilities have opened up. One is characterized by a neoclassical orientation. It focuses on the design and enforcement of the appropriate institutional context required to follow blueprints and to provide the necessary fine tuning. A second perspective is indebted to the classical-liberal tradition. Its supporters stop short of advocating extensive constructivist engagements. Instead, they tend to concentrate on the rule of law as the only relevant operational device and identify spontaneous evolution[7] as the engine leading to efficiency, fairness, and overall wealth. In particular, appropriate constitutional engineering is assumed to provide the meta-structure within which virtuous evolution unfolds and the rigor of the rule of law does not turn into abuse.

Common to these two approaches – detailed agency modeling and broad institutional design – are economists' efforts to transform the evolutionary and the rule-of-law questions into procedural issues, whereby deviations should be kept in check by better planning, more effective bureaus or voting mechanisms, suitable (economic-) constitutional means[8]. Put differently, when coercive institutions fail to achieve the

[5] Regrettably, the debt to authors like Walter Eucken and Franz Böhm (prominent among the founders of the Freiburg-based Ordoliberal School) is seldom acknowledged. Nor is there much reference to the authors who first emphasized the importance of the connection between rules and economic performance, an intellectual debt that dates back to Adam Smith, if not earlier.

[6] Commons (1924, chapter 2) observed that tampering by the US courts with the actual meaning of private of property already had a distinguished record in the second half of the 19th century, when private property was still considered uninfringeable. In particular the notion of the right to dispose of resources (goods and services) was replaced with the notion of the right to enjoy the purchasing power generated by the goods and services legitimately possessed. In the US, the task of translating satisfaction into purchasing power was first entrusted to the legislative body (the Munn Case in 1873) and later to the judiciary (the Minnesota Rate Case in 1890).

[7] Evolutionary in the sense that social interaction is assumed to follow a virtuous process of adaptation, not to be confused with the meaning attributed by the evolutionary school, according to which individuals do not necessarily adjust their behavior to produce the most desirable social results.

[8] The adjective 'economic' refers to the approach, rather than to the outcome. In particular, economic constitutions tend to adopt a consequentialist view, whereby meta-rules are engineered and evaluated according to their economic consequences, rather than according to their philosophical foundations or their moral principles. As will be pointed out later, this approach serves two purposes: it offers the possibility of suggesting an objective measurement of the quality of a legal system (e.g. by observing GDP per capita or GDP growth) and it encourages efforts to conceive a process of gradual change, from

desirable objectives of economic prosperity and social cohesion, it is assumed that the rule-making process has gone awry, and that a new corset of rules and meta-rules is called for. These new rules might not succeed in forcing the rule-makers to behave in the most desirable way, but at least they are believed capable of restraining potential abuses. This is the essence of both constitutional economics and of its extended, neo-classical-oriented counterpart – modern political economy.

The sections that follow will ignore the solution based on agency design. Such analysis would necessitate a case-by-case study of the policy objectives to be attained, which either requires the (hopeless) identification of a suitable social welfare function, or falls within the realm of law and economics, which is explored elsewhere. As for the constitutional alternative, we obviously discard situations where meta-rules are based on individual explicit or quasi explicit[9] consensus, for these are actually exchange agreements, or at most extended versions of default contract law with opting-out clauses; certainly not constitutions. However, when explicit or quasi-explicit consensus is ruled out, we are able to raise two objections. First, we shall maintain that all meaningful constitutions do in fact rest largely on a set of arbitrary, non-accountable decisions. In particular, when based on a general social principle which subordinates the individual to the *polis*, then constitutions are in fact decrees defining the General Will. Second, we underscore that constitutions are made by human beings, most of whom are also responsible for ordinary law making. And those meta-rules, no matter how solemn and grandiose they sound, are enforced by other individuals, closely connected with the rule-makers. Either the latter appoint the former, or the former contemplate the possibility of becoming rule-makers themselves or of occupying positions that require approval by the rule-makers. This mixture is not without consequences.

In fact, we posit that the only substantial differences between constitutional laws and ordinary laws are the historical events that justify the former and, once constitutions

---

the current situation to a better one, with each discrete step being appreciated one at a time. That allows to do without intertemporal modeling and simply settle for easy-to-perform, 'what-if' exercises (groping).

Political constitutions present a much more differentiated gamut, but can be broadly grouped in two categories. Sometimes they are conceived as a barrier to prevent political abuse against individual rights (the American case); under different circumstances, they have a merely symbolic value, to mark the end of a political regime, with a list of desiderata the new class is supposed to pursue and attain (the French case).

[9] For the sake of argument that follows, we here assume that explicit consensus occurs when the individual overtly agrees to underwrite all the parts of a hypothetical social covenant. Quasi-explicit consensus applies when the social covenant is put into operation by default (tacit consent), but opting out is always possible at no costs.

are introduced, what it takes to change them – simple majorities vs. more stringent numerical requirements[10]. Still, there is no a-priori reason to believe that laws approved by larger coalitions are better than others, or that they necessarily provide effective restraint. In order to assess whether constitutions are good or bad, one has to clarify what kind of ordinary law-making they are supposed to prevent or generate. To do so, one needs reference to everlasting principles. Relativism provides flexibility, but porousness at the same time. When a large number of robbers are involved in a crime, possibly on a massive scale, the crime is not necessarily transformed into a noble deed or into a tolerable evil just because it involves many aggressors and many victims. Redistribution and bailing out at the taxpayers' expense a bankrupted large company are fitting contemporary examples, respectively. More realistically, it is easy to imagine that the larger the number of people required for approval, the greater the probability that the outcome turns out to be a set of vague platitudes, rather than effective barriers against abuse. In a sentence, unless they establish objective principles, virtuous meta-rules are wishful thinking for the scholar, a valuable façade for the rule maker.

The practical consequence is that the more stringent the majority requirements needed for change, the more likely it is that modifications are carried out by judicial interpretation, rather than through legislative processes. This can have advantages, if one believes that rule-making should be shielded from demagogic pressures. But the same argument can be used in the opposite direction, if one believes that in a democracy rules should reflect popular will, or that it is easier to appoint and influence a small number of Constitutional judges than large numbers in Parliament.

The second part of this paper suggests a different, mainly explanatory approach to the features and dynamics of policy-making based on what we call 'deep institutional

[10] See also McGinnis-Rappaport (2007) for a detailed analysis of the virtues and shortcomings of super-majority voting.

This is often considered to be a matter of substance, which provides stability to the rule-making system. Although this is obviously true, some qualifications are in order, since rule-makers have ways to circumvent majority or super-majority resistance, or to weaken its effectiveness, or to soften the constitutional watchdogs. For instance, the incumbent rulers might find it advantageous to act through the appointment of the members of the constitutional court, or by putting pressure on the ordinary judges, who may serve specific interest without necessarily betraying their own convictions. On the other hand, in modern democracies self-restraint by the incumbent winners (who can be future losers) may prove more powerful than super-majority rules. This does not mean that the rules last forever, but that proposals for change tend to be bipartisan and characterized by informal, non-written agreements, rather than confrontational. Examples along these lines are offered by the attempts to enact procedural reforms (e.g. electoral rules).

changes'[11]. The fundamental idea is that the grand principles characterizing a civilization and driving the institutional environment – rule-making and the reaction to rule making – undergo fairly sporadic change through time. Put differently, the alterations in the ways social interaction is recognized and accepted by the members of a community vary through time as a consequence of ideological evolution. Of course, ideological developments are not sudden and their origins can be traced throughout decades and even centuries. However, it is here upheld that the translation of ideas into shared perceptions and norms takes place rather quickly and is often the result of accidents, or of a combination of accidents: obvious examples are a famine, the presence of outstanding or extremely poor leaders, a war. Nothing, however, happens to the institutional context if there is a famine and only a famine. Similarly, nothing happens if a revolutionary set of ideas is brought to the surface by brilliant intellectuals and effective popularizers, but the spark to ignite change is absent. By contrast, grand history may be born anew once the rise and spreading of new ideas coincide with a major accident – such as a war or a natural disaster – that forces people to look in new directions and seek new solutions. In such moments the perception of politics is also altered, with repercussion upon people's beliefs about the nature of political action and ultimately expectations about policy-making.

The periods of time defined by the deep institutional changes are named 'historical periods'. Common to all historical periods is the fact that policy-making remains driven by a single engine, the quest for authority and power; and that it is subject to two constraints: the ideological environment and the available technology. It is therefore maintained that all the rest, including evolutionary selection processes or other path-dependence mechanisms, plays a secondary role or perhaps no role at all.

With this ultimate goal in mind, section 3. critically reviews the constitutional approach, while section 4. discusses the notion of deep institutional change as a way to explore the nature and working of meta-principles. Section 5. compares the deep-institutional-change thesis with the institutional and the evolutionary views and section 6. concludes by developing a cautious agenda to test the implications and predictions of the various propositions.

[11] As a matter of fact, the normative implications of our approach are not negligible, in that it excludes the viability of 'rational', efficiency-based or efficiency-enhancing policy-making. Instead, it suggests that those who want to alter the scope of policy-making, or change its nature, act in order to bring about 'deep institutional changes'.

3. Social contracts for policy making

As aired in the previous section, today's political economy investigates the mechanics of politics by relying on the modeling tools typical of modern neoclassical economics, thereby making deliberate use of extremely simplified assumptions and ultimately leaving economic reasoning in the background[12]. Its ultimate aim is to design the rules of the game required to reduce the impact of rents and rent-seeking structures on efficiency and growth. No serious effort is undertaken to investigate the ideological or moral foundation of the rule-making systems. Hence, the nature of the bond which keeps together rulers and citizens is taken for granted (and thus ignored), while research focuses on analyzing how rule-makers interact to share and maintain power, on assessing what kind of economic consequences the various idealized patterns of interaction are likely to generate in an allegedly value-free environment[13], on testing the effectiveness of distinct governance options to create incentives for allegedly virtuous rule making and rule enforcement.

A different and possibly more interesting approach from the speculative standpoint is offered by the 'new contractarians', a group we consider to be synonymous with 'Constitutionalists'. Their view suggests that although the principle of atheistic democracy[14] is an adequate foundation for a political system consistent with the classical-liberal standpoint, economic policy-making also requires meta-rules, which define the boundaries of state action and avoid or restrain abuse by the rulers. The foundations of such meta-rules are thus spelled out in a new version of the social contract, the analysis of which forms the object of the present section.

The reason for concentrating on the constitutional contract is that it currently represents one of the two credible attempts to develop a system of principles in favor of policy-making – the other one being the Law-and-Economics vision (or part of it). In a

[12] See for instance Weingast and Wittman (2006), who characterize political economy as a technique, rather than as a subject matter: "the theory is based in mathematics (often game theoretic), and the empirics either use sophisticated statistical techniques or involve experiments where money is used as a motivating force in the experiment" (p.4).

[13] See Lewis (1944/2001, chapter 2) for the contradictions typical of all efforts to evaluate results in a context where Natural Law or First Principles are excluded.

[14] The term was coined by George Santayana in 1937, as quoted in Dougherty (2000: xii).

word, the 20th-century Constitutionalists[15] contend that under certain circumstances, the state can legitimately encroach upon individual rights, even without explicit consent. Legitimacy to do so is based on the implicit/tacit social contract, through which the individual has passively accepted the authority of the state. The tacit option is made acceptable by the fact that the content of the contract is such that the individual would never abstain from accepting it, if given a chance to express his opinion. That is why an explicit contract is redundant and the cost of obtaining it can thus be ignored. If this presumption is agreed to, then coercive action would not conflict with a free-market context and it would also avoid the post-Millian tradition's slide into utilitarianism. That explains why this claim has appealed both to those who believe that government intervention is excessive and to those who cherish the idea of good government, but do not like to be accused of disguised socialism.

The presumption of tacit agreement comes in two versions, depending upon the content of the silent pact between the individual and the authority. One version can be defined as Constitutional *stricto sensu* and will be examined below. The other is the quasi-minimal thesis and will be discussed in the subsequent sub-section.

Questioning the Constitutional contract

According to the Constitutional version, current institutions have been designed or inherited by actors who have rents to preserve and who therefore try their best to prevent a virtuous evolutionary path from running its course. This explains why we live in a bad world and not much is being done to move toward a better state of affairs. Thus, in order for people to agree on a social structure, the ground must initially be cleared from pre-existing power structures that *de facto* make it impossible to agree on a social covenant among equals (non-equal meaning conditioned by the past). This rent-free environment where the ideal (tacit) covenant takes place is characterized by a 'veil of (Knightian) uncertainty'[16], behind which people agree on the meta-rules that define a

[15] See for instance Hayek (1960), Buchanan and Tullock (1962), Brennan and Buchanan (1985, ch. 2) and Jasay (1992).

[16] We classify the lack of certainty in three groups. Risk indicates a situation where the individual knows what might happen and knows the probability distribution of the event. For instance, we know that by tossing a coin there is a 50% head probability and a 50% tail probability. Knightian uncertainty refers to a situation where the range of possible events is known, but their probability distribution is unknown. Future stock prices are an example. Pure uncertainty refers to the lack of knowledge about events (guessing does not count). For instance, we do not know how we shall be producing energy in 300 years from now.

society. Of course, implicit in this statement is the belief that absent consolidated rent-seeking, the individuals would spontaneously choose the 'best' system of meta-rules, which would in turn eliminate or drastically limit the possibility of having bad norms. This spontaneous optimal choice taking place in a world without a past is the constitutional, tacit, social contract.

In particular, the veil of uncertainty does not deny that rents might be created, but it ensures that the meta-rules are agreed-upon and enforced before any individual has had a chance to create or enjoy privileges. In order to identify these meta-rules, the following thought-experiment is suggested. Suppose that a group of individuals came to earth with no past (i.e. no rents), had to decide whether to form a community and debated about the rules that should characterize such a community. Most likely, their fundamental choice would regard the amount of rent-seeking that the social rules of the game to be would allow. In order to make his choice, each potential member of the community would then rationally evaluate his/her chances of successful rent-seeking in a future society. Every individual knows what the world out there looks like and has some notion about his likely positioning in such a world (Knightian uncertainty does not mean ignorance). Nonetheless, he is assumed to be unable to assess his chances for rent-seeking and, more generally, his ability to exploit the opportunities that life may offer, or the probability of suffering from failure. This inability is greater, the longer the time horizon. As a result, if the constitutional features are to extend over a long-distance future in order to enhance stability, and if the constitutional meta-rules are abstract enough (i.e., they consist of very general principles about what rulers can and cannot do), uncertainty makes sure that risk-neutral or even mildly risk-loving individuals opt for a system of constitutional norms that severely restricts the ruler's decision-making power[17]. In other words, behind such a veil, individuals believe that their expected rent-

[17] A different (and equally popular) kind of contract has been conceived in Rawls (1971). Contrary to the classical liberal tradition, however, Rawls posits that the authority is entitled to act by presuming that the individual chooses behind a veil of ignorance, has no hope to be the architect of his own future and therefore to achieve his goals by engaging in hard work and entrepreneurial activities.

Despite its name and contrary to Rawls's claim, however, this is not a contract, let alone a fair contract, for in the Rawlsian world the ruler *de facto* prevents individuals from engaging in social activities unless they accept to behave as if they were ignorant, both about the world to be and about their own abilities. Put differently, Rawls's intellectual experiment is a presumption about individual behavior formulated by the ruler in order to justify his own discretionary action. Rather than a contract, it looks like a self-serving argument, though a Rawlsian could respond to this criticism by arguing that the approach can only be attacked by those who have broken through the veil of ignorance and therefore have distanced themselves from a fair starting point.

seeking gains are significantly negative, so that even the risk-loving members of the society are inclined to subscribe to a constitutional rule that prevents rent-seeking and sets substantial limits to the regulatory and spending/taxing power of the state[18].

Two sets of comments are in order. First, this line of reasoning rests on critical assumptions about – for instance – the probability of winning the rent-seeking game, which declines as rent-seeking becomes increasingly concentrated in the hands of the elites, which affects the bearing of the risk-aversion element; the profitability of rent-seeking; the sustainability of rent-seeking (if the rent-seeking opportunities are periodically randomly redistributed, there is not much reason to strive to create privileges and appropriate them)[19].

Second, it is equally clear that within the Constitutional framework the role of the state has nothing to do with the protection of fundamental rights (e.g. natural rights), since the existence of fundamental, objective rights is explicitly denied[20]. No ethical component enters the contractarian picture: the social agreement is sovereign and ruled by moral relativism. Even the notion of justice takes an unusual meaning, for 'just' no longer reflects compliance with principles, but is made equivalent to submission to the agreed-upon meta-rules. Therefore, consensus prevails upon ethics in three different ways: (1) when the tacit agreement behind the veil of uncertainty defines the meta-rules, so that justice is ultimately the content of such meta-rules; (2) when justice acquires a normative dimension, in that 'just' is what eliminates contradictions among possibly

---

Of course, the problem with the Rawlsian theory is that one's vision of the world cannot be labeled unfair just because it rejects the logical non sequitur whereby fairness necessarily implies blindness and possibly also inaction. It happens that the only rationale for the Rawlsian position is based on the assumption that individual qualities are distributed at random by some superior authority who dispenses his gifts to societies, rather than to individuals. Thus, nobody can object to redistribution, for those talents are in fact social property, not individual's property. Of course, the counterargument can take different shapes: (1) why should intellectual and physical features be redistributed only among human being and not include animals? (2) how do we know that the superior authority gave away gifts randomly in the expectation that we carry out redistribution? (3) how do we know that it all comes from a superior authority?

[18] Brennan and Buchanan (1985: 55) define this attitude as "quasi-risk aversion".

[19] At first sight one might wonder why the contractarian view must go to such lengths to imagine a veil of uncertainty. Yet, there is no other way. One cannot simply outlaw rent-seeking per se without referring to some moral standard outside the realm of individual choice. For instance, if one maintained that rent-seeking is unacceptable because it is based on coercive norms that restrict the individual's freedom to choose, one should accept the principle of unrestricted personal freedom and give up a claim to an amoral social covenant. Similarly, it cannot be claimed that people agree on a social contract without knowing where they would end up unless the veil is lifted, for this would in fact be Rawls's pseudo-contract.

[20] See for instance Brennan and Buchanan (1985: 22).

conflicting rules[21]; (3) when the object of politics is established, and the role of the state is ultimately understood to be the production and financing of collective goods, even when this may imply encroachment upon individual liberties so as to avoid 'major' damages to other parties.

In this light, we posit that the constitutional perspective suffers from two weaknesses. One is logical, the other operational. From a logical standpoint, the main problem is the role of the veil of uncertainty as mainstay of an agreement on the meta-rules. Even if one accepts the veil as realistic, the existence of such an agreement can only be imagined, for individuals are not identical and therefore – contrary to the constitutional view – they do not necessarily share the same wishes with regard to the way a society should be run and state intervention restricted. For instance, some might want the state to protect the individual from coercion; others might claim that coercive taxation is tolerable to relieve poverty or to compensate people from natural or 'systemic' catastrophes; still other groups might favor equalitarian redistribution no matter what. Hence the tacit contract would not be too far away from an exercise in figuring out how a typical individual imagined by the social scientist would behave and what he would choose. To be fair, the Constitutional response would be that the tacit contract is in fact a residual contract, in that it identifies the body of meta-rules from which nobody has opted out[22]. This is hardly convincing, though. On the one hand, one could therefore conclude that the Constitutional state is not a real state, but only an agency that provides services on demand to those who want to buy protection, redistribution, fairness, etc.. On the other hand, if the state that emerges from the social contract maintains its standard monopolistic prerogatives, it is hard to see how one can opt out of a set of rules that does not allow competing systems to come to the surface. For instance, can one opt out of a state educational system if all private education is

[21] This notion of justice is not entirely new, of course. See for instance Dworkin (1986), who claims that the law is just because it creates a social order. Hence, the moral dimension is the ability to create consensus and eliminate inconsistencies. It seems that the difference between Dworkin's 'interpretive view' and the Constitutional view lies in the legal space where consensus is to be reached. According to the former such a space is not restricted and includes both meta- and ordinary rules, whereas according to the latter the emphasis is on the potential conflicts among meta-rules only.

[22] The constitutional contractarian perspective explicitly states that consensus can be assumed by default if an individual takes part in social life while having the possibility of opting out (see Brennan and Buchanan 1985, chapter 7). Do they really mean that after having written a registered letter to the President, one can stop paying taxes? Despite Buchanan's very critical attitude towards the role of the state in modern societies, we believe that his failure to opt out is not to due to fear of President Obama's reaction, but rather because he does not really consider it would be consistent with his own constitutional context, which is also the only legitimate context he recognizes.

outlawed or severely restricted in a given territory? Or can one build his own house on his own piece of land after having rejected a law that prescribes that building permits are compulsory for all activities in the construction industry? Surely, one could object that these two examples refer to ordinary laws, rather than to meta-rules. It should be observed, however, that if meta-rules are not about absolute moral principles, then they are necessarily about objectives to be attained through ordinary legislation. Changing the required majority for approval does not transform an ordinary norm into a meta-rule. At most, it changes the decision-maker, as pointed out earlier.

In short, it seems that the purpose of the Constitutional state is to legislate more or less at will, and then allow the members of a society (as defined by the state?) to decide whether they like the various pieces of legislation or whether they would like to opt out. Not only would this be hardly manageable from an operational standpoint, but it would lose all its 'constitutional' content. Put differently, either the state no longer exists (for a state without absolute power to enforce its rules is no longer a state)[23], or its meta-rules drop their distinctive meaning and are reduced to a mere façade.

From the operational vantage point, the constitutional proposal does deserve credit for not attempting to design an optimal set of meta-rules *ex novo* or to engage in constructivist experiments, but 'merely' to reform the institutional context in democracies, where all individuals are allowed to express their views. However attractive this may appear, the difficulties remain daunting. For in order to unleash a constitutional evolutionary process, individuals must be pushed back behind the veil of uncertainty, be reduced to the typical agent so as to make sure that they all share the same notion of the collective good, and/or their time horizon should be stretched considerably. Otherwise, individuals would be fully aware of their chances to acquire privileges and would raise the cost the losers would face by opting out, or even prevent them from doing so.

To conclude, the Constitutional contract would be not only hard to enforce, but also difficult to rationalize in the very light of the (questionable) constitutional notion of justice, which is defined according to the prevailing rules, rather than to general principles outside man-made legislation. Then, in order for the constitutional project to

[23] Instead, the state would become either an insurance company (among many others, with no monopoly power, let alone on violence), or an advanced stationer's shop where one can buy pre-printed contracts, possibly with a guarantee of enforcement provided by the stationer himself, either by default or on demand.

see the light, the accent would have to be on revolution rather than on reform. Nonetheless, even if the Constitutionalists were happy with revolutions (which is not the case), revolutions are by nature teleological, which means that some kind of constructivist engagement is unavoidable; or that First Principles (objectivism) must be accepted. Still, both of these propositions run against the very claims of the constitutional vision.

Doubts on the quasi-minimal contract

Jasay's quasi minimal approach[24] was conceived as a response to the classical-liberal view derived from John Stuart Mill, according to whom the state is legitimized to act in order to prevent individuals from being harmed. This classical-liberal, almost Hobbesian statement, however, supports two deceptively convincing concepts of liberty: freedom from damage (as maintained by J.S. Mill himself) and freedom to follow the rule of law (F. von Hayek). Both are open definitions, in that they offer much room to interpretation and have ultimately become rather porous. Thanks to J.S. Mill himself, for instance, freedom from damage has become the right not to suffer as a result of the actions of other members of the community. The Hayekian definition goes in the same direction in that the rule of law is meant to protect the individual from other people's misbehavior. In fact, both definitions generate a full range of questions, and are far from settling the issue. For in both cases it all comes to defining and interpreting the border between encroaching upon one's legitimate rights (which requires action) and suffering from indirect effects (which doesn't).

[24] See Jasay (1992), who calls his approach 'strict liberalism'. Of course, Jasay is neither the father, nor the only advocate of the quasi-minimal state. For instance, Mises was also arguing in the same vein decades ago and Holcombe (2004) has made the case once again in more recent times. However, Mises and Holcombe justify the state as a burden to endure, lest worse situations materialize (chaos or rival bandits fighting for short-term rent-seeking); and express hope, rather than confidence, that the state does not abuse its powers and stays small. On the other hand, Jasay focuses on the allegedly contractual nature of the quasi-minimal state and therefore gives its existence a moral justification, rather than referring to mere expediency.

To complete the argument, it is worth mentioning that the minimal proposal differs from what we define as the quasi-minimal version, in that while the latter does not rule out that the state performing some economic functions, the former aims at restricting the role of the state to the protection of physical integrity (Hobbes) and of private property rights (Locke). Hence, it is actually closer to the views typical of the Secular centuries, to be explained in the next section. The minimal proposal, however, will not be further explored in these pages.

This shift of emphasis, away from the traditional idea of freedom-from-coercion, had been noted long ago by the old institutionalists[25] and has in fact gradually led to the crisis of the classical-liberal framework, which has lost much of its identity by engaging in hopeless fights over interpretation and hair-splitting. Confusion and ambiguities have followed. For instance, liberty as the right not to suffer damage inevitably imposes limitations on the others' freedom of action; whereas liberty as the ability to follow procedurally correct rule-making, not unlike what we have already observed in the constitutional case, leads to a notion of justice (and legitimacy) equivalent to compliance with the rules, a conclusion that not every classical-liberal brought up in the Scottish tradition would subscribe to.

Jasay is very clear about the classical-liberal ambiguity and rightly believes that neither damage avoidance, nor Dewey's pragmatic moral philosophy[26] are sound bases to justify violations of the freedom-from-coercion principle. Instead, he claims that since the state can only be the expression of the will of a community (as opposed to the will of God, let alone of an autocrat), the state can only be founded on a contractarian approach. In particular, in Jasay's view the typical feature of a legitimate contract is its ability to originate Pareto-improvements, whereby none of the agents involved is made worse off in comparison with the situation prevailing before the contract is signed and put in force. All actions or policies enforced by the state are then subject to the same validation criterion. In addition, and contrary to the Constitutional perspective, the quasi-minimal approach has moral foundations. They are individual liberty from coercion, as mentioned earlier; and private property based on possession, unless possession is derived from violence or fraud (both circumstances being of course departures from the personal-freedom principle).

The quasi-minimal proposal is attractive, in that it contains neither implicit and possibly questionable assumptions about the individuals' attitude towards risk, nor arbitrary and less than plausible conjectures about the nature and dynamic features of rent-seeking. In addition, the political construction Jasay envisages does not necessarily depend on religion and thus on concepts that require the existence and acceptance of a divine order. The emphasis is actually on the secular version of the natural-right approach, which rests upon the concept that each individual is born a free man, which in

[25] See for instance Commons (1924).

[26] See Dewey (1934) and Dougherty (2000, chapters 4 and 7) for a synthetic critical analysis.

turn implies that nobody can uphold any right on the newly-born creature[27]. This is indeed all one needs to postulate in order to develop an argument based on natural rights. In this particular case, the nature-based claim to freedom rules out the right to exercise physical aggression, and thus the duty for the victim to accept it or to negotiate compromises within the social body.

It then follows that when it comes to formulating sets of formal rules in order to discipline social interaction, the role of the state actually becomes a matter of individual choice. It is up to the individual to decide whether and under which conditions to engage in trading with the rest of the community (one or more individuals), how to act or not to act in certain ways while obtaining goods or valuable behavioral commitments by his counterpart(s), how to choose an enforcing agent. Since no exchange would take place voluntarily without at least one party being better off, and with none of the parties being worse off, Jasay's Paretian social contract is indeed moral (i.e. 'just' in the traditional way) and persuasive.

Still, the quasi-minimal contract also presents a number of unresolved issues. On the one hand, it depends on the *a-priori* general recognition of an alleged man-centered natural right (individual freedom), which is indeed readily enough conceived, but not necessarily accepted by everybody. For instance, one can also argue for a natural-right vision based on the social nature of man. If moral (and therefore just) is what leads to the realization of human nature, and the human being is supposed to realize himself only in the social context, then freedom is subject to what is needed for the individual to be part in a social context, which of course necessarily requires that the nature and goals of a virtuous society must be defined in advance. Hence, two possibilities open up. Either the individualistic notion of freedom is rejected, which would however imply the downfall of the Paretian-optimality constraint on the quasi-minimal social contract. Or, one upholds the strict individualistic line, but at the cost of undermining the very notion of a social contract, which would be in fact reduced to a set of individual agreements (voluntary exchange) to do or not to do.

Indeed, and this is a second point, one wonders whether state interference legitimized by Pareto optimality needs any coercion at all. If the answer is negative,

[27] See for instance Hohfeld (1923). An alternative option is aired in Lewis (1944/2001, Appendix), who identifies a system of Natural Laws based on a set of traditions shared by different civilizations. Such Laws are Beneficence, Duties to the Family, Good Faith, Mercy, Valor.

then there is no reason to have a state enjoying the monopoly of violence and the power to use it. Furthermore, and from a broader standpoint, one may wonder whether Pareto optimal deals are indeed suitable to legitimize a social contract. In theory, one may welcome an agent that reduces the cost of carrying out business. But of course this is not enough to justify monopoly power, and even less the use of violence. Put differently, Jasay's quasi-minimal contract is really a standard contract. Calling the counterpart 'the state' makes no difference, especially if one deprives the states of its main prerogatives (monopoly of violence and impunity when infringing upon individual liberty).

Equally important, one should also solve the practical problem of designating those in charge of assessing whether a given course of action is actually conducive to a Pareto improvement. The standard literature sidesteps the question by referring to the existence of public and collective goods: it does not really matter who is in charge as long as he takes care of producing the necessary public and collective goods and gets punished or removed if he fails to do so, or does it at an exceedingly high cost. But definitions are not enough from a subjectivist standpoint. Public goods require that the non-rivalry and the non-excludability criteria apply. Still, the very fact that an individual might consume goods or services without affecting the scarcity constraint others are facing, and that the producer is not able to detect who is actually consuming (and how much), is not a reason to tax the individual and force him to pay the (fixed) costs of production. In other words, even in a world characterized by a quasi-minimal social contract, discretionary/arbitrary power is required to guess both the amount of presumed consumption and the subjective value associated with such an activity[28]. By doing so, one necessarily violates individual freedom. Claiming or guessing that the victim (the taxpayer in this case) is actually free-riding makes little difference to the essence of the question[29]. Envy is hardly a good enough reason to generate a presumption of fraud and thereby 'legitimize' intrusion.

---

[28] It remains to be assessed whether public goods really exist, i.e. whether such a condition relates to the nature of the good or service (zero marginal cost of production), or to the technology of property-right enforcement (excludability). In fact, crucial to the argument is that excludability is about detection: if an individual consumes good X in ways that violate his agreement with the seller (e.g. photocopying a book), he is not taking advantage of a public good, but of weak enforcement abilities.

[29] The pure free rider is not really doing anything immoral, for he is not encroaching upon anybody's liberty. If anything, he might be cheating, for he might be consuming against the producer's will, while denying doing so. But of course, if we were able to prove that the individual is actually lying, then the non-excludability criterion would be violated and it would no longer be a public good.

The case for the so-called collective goods[30] would of course be even weaker, for in this case the very definition of collective good depends on the ruler, who may of course have his own ideas about what is good for society, what should be provided by the state and at what conditions. From that vantage point, and contrary to the primary design of the advocates of the quasi-minimal state, the Pareto criterion might thus turn out to be the key to legitimize discretion, rather than to delegitimize extended government intervention.

Finally, and similar to the Constitutional case, one might object that this is actually a proposal for revolution, where change requires starting from scratch, rather than for reform, where the starting point is the current given context. Clearly, if the appropriate size of the state is defined by incremental steps based on the Pareto-optimality criterion, the experiment can only start from a situation in which there is no state. Downsizing a large state would go nowhere, unless nobody was enjoying rents, which is wishful thinking. The only way out would then be a 'what if' exercise behind some sort of veil, which however would meet objections not unlike those already raised earlier on within the constitutional context.

4. Deep change and historical periods in Western civilization

The preliminary conclusion of the argument developed so far is that the foundations of economic policy-making are logically weak, unless one is ready to identify and able to justify the notion of social welfare. This possibility has been here denied. In particular, modern social-contract theory offers little help, for either these theories boil down to academic what-if exercises based on questionable assumptions, or they actually refer to the state as an entity which has little to do with the traditional state, and thus would have no power to enforce policies.

As previously suggested, a different and perhaps more fruitful way to consider the legitimacy of today's policy making is to take for granted that the large majority of

[30] It is far from clear what economists understand under the label of 'collective good'. Nonetheless, it is generally acknowledged that this category identifies excludable goods that are necessary for the existence of social interaction and/or represent shared values (e.g. access to health or education for everybody) that private suppliers fail to offer at the socially desirable conditions. Put differently, their existence depends either on the idea whereby there is no freedom outside the appropriate social context (defined through a given procedure), and/or on the existence of market failures combined with the presence of a social welfare function and the absence of substantial government failures.

the population does support substantial government intervention in most areas of economic activities, and therefore to put a different type of question. Rather than asking 'how can one churn better rules', or 'what is the optimal size of legitimate government', we suggest raising the question of 'what makes government intervention perceived to be legitimate'.

The answer we provide revolves around the notion of the historical period, which spans from one moment of deep institutional change to another. Each historical period is characterized by a distinctive, general perception of the rules of social interaction. A modification in these perceptions may lead to new procedures to designate the agents in charge of enforcing the agreed-upon coordination devices (including contracts), to select those responsible for producing rules, goods and services on behalf and to the benefit of the community, and also to determine how desirable 'collective' services are identified and paid for. When so, deep institutional change (i.e. change in the shared perceptions) coincides or brings about political transformation and a new historical period begins.

This does not ignore that constitutions exist, but it emphasizes that the content of a constitutional framework is defined or at least heavily influenced by what a political body of people – a small community, a nation, an empire – believes to be acceptable[31]. It also encourages those interested in exploring the constitutional and institutional environment of a period to pay particular attention to the features of the historical phases under scrutiny, which are here assumed to be far less dynamic than commonly believed. In particular, it is here maintained that within each of the three historical periods defining Western civilization to be presented in some detail in this section, the rules of the game did not adjust following any recognizable evolutionary pattern (contrary to the path-dependence thesis), and that efforts to innovate through constitutional law-making are bound to be vain (contrary to the constitutional-economics literature). Top-down projects are successful only insofar as they reflect the shared ideologies of the given historical moment. Thus, they are a byproduct of their time, rather than an innovation per se. This does not exclude that constitutions can bring about or ease change. But when successful, even their innovativeness springs from a

[31] History abounds with cases in which such changes took place in the absence of written constitutions, as in 18th century continental Europe; and also with situations in which constitutions were left intact throughout rather dramatic periods, as in Italy between 1848 and 1946, a time span during which the country definitely did not offer a homogenous institutional environment.

certain context, and not 'any' context would do. On the other hand, proposals relying on a bottom-up approach tend to share the weaknesses of the contractarian approach examined in the previous section.

Our thesis is that the history of Western Civilization can be split into three periods: the Gregorian Centuries, the Secular Period, the Age of Social Responsibility. To each of them specific grand rules of the game can be attached, which might help understand why economic policy-making became an issue only towards the end of the second period and why it developed into a major component of societal interaction only in the last.

The Gregorian Centuries

There is a general tendency to locate the birth of the West[32] in the High Middle Ages, more or less when ancient political philosophy – stoicism in particular – met Christianity[33] and a number of simmering questions were put on the table. By and large all such questions converged onto two basic issues: defining the legitimacy of political authority, and establishing the purpose and the boundaries of political power. The result of the debate – which for some decades actually meant bitter conflict – was a body of shared values usually referred to as 'the Gregorian Revolution' (late 11th century). Such values were critical to the formation of the West, for they identified the 'true' source of power and authority, the relationship between the authority and the rest of the community, the role of each individual within the community. For the purposes of the present discussion, we call these features the first deep institutional change in the West, which marked the beginning of the first historical period of our civilization, lasting for some 600 years.

The Gregorian Revolution takes its name after Pope Gregory VII, who in 1075 AD challenged the primacy of the secular ruler by issuing the 'Dictates of the Pope', a

[32] True enough, the literature refers to many West's, e.g. the Hellenistic, the Classical, the Modern. For the sake of simplicity we shall henceforth refer to the West as to the 'modern West', that is to a civilization based on the notions of individual responsibility, equal dignity and of advancement by the use of reason, separate from faith (hence, the secular separate from the religious).

[33] As in any societal system, the Western context defines the role of the individual in a community. That involves the definitions of the relevant set of constraints and therefore also the nature and origin of the legitimate rules: "True law, Cicero taught, is right consonant with nature, available to all, constant and eternal … common to God and man … The state is nothing more or less than a partnership in law, an assemblage of men associated in consent to law. […] Christianity taught that man is the creature of God, … brotherhood of man became the brotherhood of man under the Fatherhood of God" (Dougherty 2000: 13-14).

declaration that disavowed a long tradition whereby the Emperor was recognized as the supreme authority in both religious and secular matters[34]. In order to reach his goal, Gregory VII had to raise the question of legitimate power. As a matter of fact, the outcome was already secured as soon as the very issue of legitimacy became open for debate, since all the parties concerned acknowledged that the answer could only come from the notions of natural order and Divine Will on the one hand, and from the assessment of the nature and goals of the individual within society on the other.

In addition, the Emperor had to accept the change in the rules of the game imposed by Gregory VII and his successors for one very practical reason. Until the 11th century, the secular sovereign was a barbaric ruler: rather than ruling, however, he would act as coordinator of a more or less large number of tribes. They would share the same religious faith (a very soft and accommodating version of Christianity) and be forced to cooperate in order to oppose attacks from outside (Magyars, Normans, Arabs). The only way to show sovereign power was thus leadership in battle and the only tangible sign of civilian rule was the somewhat symbolic right to administer justice (even Charles the Great was traveling from one corner to the other of his domain to this purpose, thereby making sure he would still recognized as the current ruler). As we know, the substantial decline of threats from outside Europe, the increase in wealth that followed, and thus urbanization, led to a situation where the Emperor became de facto redundant militarily, while the prevailing version of Christendom was not enough to make him necessary as the head of a religious structure: bishops and monasteries were more than enough to meet believers' needs. In a word, the Emperor had to rely on the Church in order to legitimize his power and to give a meaning to his role[35]. Destroying the Church would have been suicidal.

The most important result of the Gregorian Revolution was the birth of the law (Berman, 1983). Both the Church and the Empire were forced to recognize the existence of rules, embedded in the Divine Order, discovered by reason and revealed by God, to

---

[34] Prior to the Gregorian revolution the Emperor had the right to the title of Vicar of Christ, while the Pope was some kind of super-bishop (the Vicar of Saint Peter), all other bishops being appointed and *de facto* controlled by the Emperor. The West had to wait until Pope Innocent III (early 13th century) for an exclusive papal claim to the supreme title.

[35] The Emperor played also a third function, which has sometimes been overlooked by the literature. Given the semi-tribal composition of the empire, the local princes needed to coordinate their activities in order to give each other support in case of domestic revolt. The Emperor actually acted as the coordinating agency of this system of personal alliances. As the tribal features faded, the prince had to rely on other sources of legitimacy, such as the supra-natural.

which all secular and religious authorities were subject: 'rule by law and under the law'. Other important outcomes were the notion of equality of all individuals before God, to whom we are individually responsible; and the teleological view whereby the individual has come into this world with a purpose, which is/was living according to God's Will (i.e. in compliance with the Divine Order) while preparing for death. In other words, all individuals are children of God, who loves all men equally. But all God's children have to accept the earthly order as sacred and immutable, for it is the expression of God's will.

One can of course debate at length on the details of how the belief structure of the Gregorian society came about, but there is little doubt that those mentioned above were actually the foundations of all Western early social structures:

(1) equality with respect to God, but passive recognition of God-designed social hierarchy and inequalities in this world,

(2) the existence of 'just' rules, either conceived by God or by man, but nevertheless consistent with God's design – in case of conflict, just rules were to prevail over habit and tradition;

(3) the partition between a secular and a religious world (against universalism).

This does not mean that nothing within these social structures changed. Nonetheless, institutional innovations were the results of the greater wealth produced by a combination of some technological progress, less warfare, extensive colonization of new lands; and/or by the quest for power, which often implied the creation of rents preserved by violence. It was not a question of path dependence or evolution, but rather of expanded opportunity sets that could have presented different features if some battles had ended differently, if famines or diseases had struck harder or not struck at all, if the world had not warmed up significantly at the beginning of the second millennium AD.

Put differently, the Gregorian Revolution articulated the concept that policy was a race for power, and that all secular authority is fragile. Power could be expanded and authority secured through exploitation. Of course, at the time there could be no room for a social contract, for the contract was not between the ruler and the subjects, but between the ruler and those who were supposed to confirm divine appointment and consent[36]. This also explains why policy-making tended to be directed towards the

[36] The Gregorian time does present us with allegedly constitutional documents, the best known of which are perhaps the Great Charter of León (1017), the Magna Carta (1215), the Golden Bull (1222). All these

acquisition of more and more resources, and therefore towards the expansion in territorial claims: to consolidate authority and preempt potential rivals and aggressors.

To conclude, since rulers were not chosen by anybody, but appointed by a divine agent, in Gregorian times the development of coercive, pragmatic institutions were functional to the interests of the ruling rent-seekers. In the early Gregorian centuries, when power could be exercised by relatively small armies of highly trained specialists facing equally small armies, rent-seeking was very basic: the ruler would grab what was available, possibly restrained by the religious authorities, and be held responsible to God only. In later periods, military technology (the introduction of artillery and fire arms) made it easier for competitors to challenge incumbents[37] and more sophisticated (and expensive) arrangements had to be elaborated. Sometimes, this led to the creation of the bureaucratic state, so as to improve control over the territory (Philippe Auguste was the major early innovator in this field); sometimes to alliances with the affluent elites, either when money was needed, or when centralized control was ineffective. In turn, there were situations when the elites were affluent enough to maintain or buy their independence, which meant that anointed rulers abstained from claiming rights on certain portions of territory[38]. In yet different environments, the elites bought or acquired privileges (freedoms) and rent-seeking capacity (the case of the guilds is typical, but not unique). Indeed, one can figure out so many different path-dependent or evolutionary processes that one wonders whether these notions actually carry a useful operational content.

The Secular Period

The Gregorian revolution had indeed marked the separation between the secular and the religious world, but the fact that God had remained the sovereign source of authority

---

were, however, concessions made by a weak king to the aristocracy, with very little 'social' or 'contractual' content. They consisted of a list of freedoms (in fact privileges) that had little to do with the notion of liberty as this term came to be understood in later centuries.

[37] Of course, the army had nothing or little to do with the protection of the population. On the contrary, its purpose was to control the territories owned by the ruler – to prevent revolt and enforce taxation, an operational deployment that Colbert refined in the 17th century – and to fight against other rulers or would-be rulers. Even when engaged in the defensive actions, the Gregorian princes were protecting not their populations, but their own tax-producing territories.

[38] After all, God was supposed to make his will clear with regard to who was supposed to have the authority, but not to specify the geographical boundaries of authority. This was of course a non-issue until the pre-Gregorian universalistic attitude had some appeal. As pointed out in the text, however, it became a very practical problem once universalism broke down and the figure of the ruler was secularized.

made it apparent that the monarch could obtain full sovereignty and legitimacy only by escaping the religious hold. The secular age reveals the consequences of such efforts.

Not unexpectedly, the key, and therefore the critical divide between the Gregorian and the Secular period, revolves around the assessment of the relationship between the ruler and its subjects. As mentioned earlier in this section, this relationship bears on two different levels: authority and power, although it is obvious that once the latter is questioned, the former is inevitably also open to scrutiny. The Westphalia Treaties gave practical content to the notion whereby in order for the divine order to be obtained, religious guidance and interference were not needed (Koselleck, 1979). Of course, this declaration applied to the Catholic Church as well, which in fact refused to recognize the Treaties.

In order to secularize the state, four steps had to be taken. If legitimacy for the state could no longer come from above, it had to come from below (the individual or the head of the household, depending upon what the elementary constitutive part of a society is assumed to be). Here lies the original need for a contract between the individual and the authority. In addition, natural rights had to be re-defined in order to make sure that it would be natural (i.e. morally compelling) for the individual to engage in a social covenant. Third, for the contract to be valid or to make any sense, it had to take place between equals. Finally, in order for the contract to be a 'social' contract, it could not concern direct, personal exchange, but rather focus on the development of the state as a way to protect society.

The transition was not easy[39], but it turned out to be successful. As we know, the Enlightenment brought about the switch from government based on compliance with the Divine Order, to government as a result of a contract. The contractarian element was deemed inevitable, since a natural social trait/instinct was recognized as typical of the individual, as the Greeks had already claimed over two thousand years earlier[40]. The vision of the Secular Period differed from the Greeks in two crucial aspects, though. First, all men were now equal (the Gregorian legacy), especially if Christians and with a white skin. They occupied different roles on earth, but human nature was one. Second, whereas for the Greeks an individual acquired his human nature only by becoming an

[39] See for instance Kühnel (2001) for an investigation into the many uncertainties and conflicts that characterized the birth of the contractarian state in the late 17th century.

[40] This contrasts with the Gregorian vision, whereby man is born without social instincts and society is the product of the individual's rational choice. See the text below.

active member of society, in the Secular Period the individual is born a human being: he antedates society and consciously decides to form a community. The relation between man and society – the substance of the (social) contract – can take different forms. For example, the individual's determination to be part of a society can be motivated by his desire to enhance his prosperity or his mere survival (e.g. – Grotius and Hobbes)[41]; or by the instinctive, God-instilled quest to obtain the ultimate goal of the Divine order, rationally discovered to be peace (e.g. Pufendorf); or by an encompassing utilitarian choice (man needs society in order to interact and become a rational being), which leads to a contract, which in turn defines the limits of state action (Thomasius)[42]. As mentioned above, common to all these views is the notion that human beings follow their nature only by joining a social context[43]. In other words, the individual is a human being because, and only because, his very living in a social context gives him his human qualities, develops his ability to reason and obtain his natural goals[44].

Of course, this reverses the Gregorian/medieval perspective, whereby man is born endowed with a bundle of natural rights and society is just a product of interaction, possibly a tool of self-improvement, definitely not an actor in its own right[45]. Surely, the contractarian vision also requires that all individuals (including the ruler) are subject to the law. But this no longer means equality before God and God's law, for there is little

---

[41] It is not by accident that as soon as he set foot on English soil, William III hurried to distribute a 'Declaration' explaining his contract with the English people and his commitment to guaranteeing peace and security, unlike what people feared would happen under James II.

[42] This concept will of course be further developed by Rousseau, who will claim in *Du Contrat Social* that if the individual is to obtain his natural goals within a properly-designed social context, it becomes the task of the social elites to define and offer the appropriate social rules and conditions. Of course, the difference being that Rousseau's contract is not really a contract, for Rousseau's state is legitimized neither by God, nor by the individual, but rather by an ideal. In particular, la *volonté générale* is neither the protection of individual rights (Locke), nor the expression of the general will (Hobbes). Instead, it defines what is needed in order to ensure that the individual finds and pursues his true nature after having been contaminated by a corrupt environment. Hence, the 18th century attempt to transform the nature of the contract, from one based on securing peace (and possibly property rights) to one based on the accomplishment of an ideal hidden to the normal human being by a veil of moral corruption.

[43] In this respect Hobbes was however the only author who had the courage to draw the obvious consequences: not only must an individual necessarily be part of a social contract, but all those who are outside, or who consider themselves outside have to be crushed, both because they have lost or rejected their nature of human being and because by going against their (social) nature, they represent a danger to society.

[44] As will emerge from the next section, these 'natural' goals were clearly articulated during the Gregorian and Secular historical periods, but not during the age of social responsibility. Nationalism provided a short-lived substitute, with dramatic consequences.

[45] It might be worth pointing out that the medieval notion of peace is indeed defined as the absence of war; whereas the secular notion implies an active search for harmony, not unlike what can be perceived when observing the activities of several national and transnational organizations (governments and agencies) in the age of social responsibility (which includes today).

room for God in the secular period. Rather, it is equality before man's created law, which inevitably implies equality under the ruler's law.

From the standpoint of economic theorizing, the secular vision obviously eased the transition from the classical-Greek notion of economics to its modern version, whereby it becomes 'political economy' and aims at studying the technical and moral features of economic interaction. The welfare enhancement of the whole also became part of the social contract. Hence, proper understanding of economic investigation turned out to be one of the critical elements required of the ruler.

The early classical economists saw their role cast in this very mold, and recommended limited government intervention in order to obtain social happiness and peace, with arguments partly based on efficiency (wealth creation) and partly on morality (non-interference with natural rights)[46]. Practically, however, the secular vision opened the way to policy-making spurred by the rule-makers' judgment and justified by results. Although lip-service continued to be paid to individual rights, these gradually became defined only within the framework of a social moral standard. This is hardly surprising, since individual compliance with such a social moral standard is what empowers the individual to be part of the social contract[47].

The Age of Social Responsibility

The fundamental flaw in the contractarian approach of the secular period was its very ambiguity towards the role of religion. Its weakness became particularly clear during the American Revolution, the French Revolution and the Napoleonic interval. Ironically, the first one turned out to be sustainable because it rejected the contractarian solution and went back to a new Gregorian system based on a set of God-given individual rights enforced by a Lockean ruler endowed with minimal power[48]. The

[46] Adam Smith well typifies the doubts of the early economists faced with political economy as a moral science (and a branch of philosophy), as the late 17th century authors used to claim. In fact, Adam Smith bypassed the problem by claiming that a free-market system is both morally superior (it does not violate property rights) and functionally superior (it creates more wealth) to any other system (i.e. mercantilism).

[47] It remains unclear whether ideals are enough to motivate a social contract, as Rousseau would have it. It seems that the answer is in the negative if the social contract has 'rational' ambitions, i.e. it claims a theoretical foundation, as the neo-contractarian theories would maintain. It is also in the negative from a Gregorian perspective, which denies the secular nature of the deal. But the answer might take the opposite sign if irrational elements are taken into account, such as the refusal of individual responsibility, to be discussed shortly.

[48] We suggest that the American institutional success had little to do with the very fact of having introduced the Constitution that Americans were expecting. First, because that choice was in fact the

French Revolution failed because although the peasants and most bourgeois were more or less happy about the goal of the contract (equality before the law and private property), almost everybody also thought to have full rights to his fair share of power. This was not what the Revolutionary leaders had in mind: the goals of the Revolution changed as it unfolded, disorder (and terror) ensued. As we know, chaotic conditions in France during the last years of the century were the primary cause of the rise to power of Buonaparte, a successful general who promised and delivered peace and order (at home). But it is also no accident that that very general never considered the social contract a serious basis for his power and quickly resorted to building up some kind of divine legitimacy for him and for his offspring – first through Papal crowning, then through marriage to Marie Louise.

In fact, the new historical environment that emerged at the beginning of the 20th century drew heavily on the lessons taught by the French experience of the late 18th and early 19th centuries and took advantage of the opportunities offered by the industrial revolution. In particular, the new age featured a holistic agreement that proceeded from the elites down to the people. It was a promise of peace, prosperity, qualified power sharing (through modern democracy), and it eliminated the need to conceive or refer to a suitable, legitimate contract between the individual and the ruler. Put differently, the solution to the threat of revolutionary instability and chaos was not a new definition of justice and legitimacy, but a consequentialist claim by the elites: "We rule for the good of the nation and we have the right to rule as long as we fulfill our commitment". In turn, the promise to deliver prosperity involved (and involves) three central ideas: all the members of society are given privileges, thereby transforming the economy into a system of interacting rent-seekers; all citizens are offered a chance to obtain a share of discretionary power, i.e. the race to power is open to everybody; the notion of personal

---

result of an imposition upon the thirteen colonies by an elite wary of people's emotions and thus of direct democracy. In addition, when the representatives met in Philadelphia they actually had no power to vote a new (federal) constitutional document, but just to amend the Articles of Confederation, a document that reflected well the limited support that the American Revolution enjoyed before the English Armies conceded defeat. In addition, at the time it was clear, and the delegates were fully aware, that a popular referendum might have produced embarrassing results: the Constitution was finally approved by *ad hoc* state Conventions, bypassing state congressional that had appointed the delegates to Philadelphia. Of course, the above does not mean that it was a 'bad' constitution; but merely that it was adopted neither in accordance with people's will, nor in accordance with the very principles it purported to protect..

See also Bennett (2003, chapter 4), according to whom the key to the American success lies in a system that succeeded in keeping the people involved and interested in the world of politics and in believing in productive interaction with authority. Although, adherence to the Founders' rules of the game was rather quickly forgotten, the spirit of the game remained in place for a longer period.

responsibility is reformulated and *de facto* reduced within an encompassing social context guaranteed by appointed rulers. Thus results the notion of social responsibility. As can be observed, such three promises are not a contract in order to legitimize a ruler or define the essence of 'good government', but rather a general agreement to share the newly created wealth, the only restraint being provided by the need to prevent possible reaction by the victims of this new rent-seeking game.

World War I and its immediate aftermath marked the beginning of this new era[49]. The result was and is a new version of the Rousseauian 'General Will', where managing the Will and taking action has become more important than the defining the Will; where consensus (populism) has replaced virtue; and where the democratic process has solved the authority problem.

The rent-seeking element of the deal makes all the members of a society feel entitled to take part in an illusory win-win game that distributes privileges – 'freedoms', according to the vocabulary of the Gregorian centuries – following a flexible and pragmatic (i.e. consensus-driven) criterion, subject to political contingencies, agreement about the desirable outcomes, expectations, available resources. Of course, the system is self-reinforcing if growth is satisfactory. When so, even the unhappy members have an incentive to confirm the rent-seeking principles of the social-responsibility system, and to confine their efforts to reforming its operational devices – e.g. ordinary laws – in order to change the identities of the beneficiaries and the size of the benefits. But self-destruction looms if growth is sluggish or negative, so that free lunches become manifestly scarce and promises lose credibility.

Power sharing and consensus are the other pillars of post-WWI Western societies. Power sharing reinforces the rent-seeking mechanisms and enhances consensus. Contrary to past historical experiences, power sharing during the age of social responsibility represents the possibility of climbing the power ladder broadly understood, either within the political structure or within the bureaucracy, possibly jumping from one to the other, not to mention the revolving-door options already referred to. This is now workable thanks to the greater wealth, which allows for unprecedented increases in taxation and thus an expansion in the public sector. Success

[49] The American and British experiences are of course different, for neither countries went through Westphalia; moreover, the impact of WWI in the USA was very different from that experienced across the Ocean.

sometimes depends on loyalty to the rulers' elite (top politicians), most frequently it takes place within autonomous, self-governing structures (the bureaucracy). Crucial in this game is that attempts to climb the ladder seldom fail completely. In most cases, real power sharing remains a dream, but those who give it a try remain with the hope of having a chance to do better next time and always end up with micro-rents in their pockets. Even a petty job in the civil service becomes a (passive) rent if one shirks and de facto transforms it into some sort of anticipated state pension. In this light, destroying the machine becomes pointless. Those with the political entrepreneurial abilities to do so usually find it more rewarding to try their luck and apply their skills within the system, while the less able go for the passive rents.

This forms the foundation of consensus (or lack of conflict) and also defines the limits of discretionary policy-making by the authorities, who are required to feed the rent-seeking game and at the same time generate enough wealth to meet expectations. This task is certainly easier in relatively affluent contexts, where the expected losses from social conflict are greater and therefore tolerance of abuse possibly more generous.

This context also defines the notion of social responsibility, which reflects the position of the individual within society and the way he perceives and reacts to experience. In a word, social responsibility means that individuals believe they live in an environment in which they are presented with opportunities. However, opportunities are not equally distributed, and a society based on consensus is legitimized insofar as it is able to hand out privileges (freedoms/rents) to compensate those that can claim to have been the victims of unfairness (bad luck, nature, some forms of exploitation[50]). Put differently, whereas the notion of economic fairness (access to minimum wealth) defines what is needed in order to guarantee consensus and stability, the concept of unfairness defines the point at which individual responsibility ends and taking action becomes a social obligation. It therefore happens that large areas of economic activities fall under the umbrella of social-responsibility. Noticeable examples are the labor market, but also health, education, savings (pensions) and even some manufacturing. In this light, for instance, a piece of legislation which creates a rent is no longer perceived

[50] The notion of exploitation depends on the definition of liberty. If the latter is understood as 'absence of coercion', then exploitation can only occur by means of physical violence (e.g. slavery). On the other hand, if liberty means "access to a wide-enough range of opportunities", then exploitation actually refers to all situations where one of the actors is characterized by deep pockets and the other gets the short end of the stick.

as a crime, as it would be in a classical-liberal world, where it would be pointed out that A's privilege is actually paid by the simultaneous creation of a duty imposed upon the rest of community. Instead, it is regarded as an act of collective quasi-compulsory fairness towards individuals who are not guilty for their misfortunes, who are not required to react to overcome their problems or to work hard to reach their goals, or who are simply entrusted with a mission for the common weal. Of course, whenever the agent acts in order to achieve a collective objective, individual responsibility for the outcome declines and the potential cost of failure becomes a cost for society as a whole to bear.

5. Summing up: the historical rules in perspective

To be honest, the historical approach put forward in these pages does accept the contractarian starting point, in that it recognizes that a society can only be created by individuals. It also shares the view that the intrinsic strength of a community depends on the extent to which a set of interacting agents believe that cooperation serves their own interests. Furthermore, it is fully acknowledged that cooperation works better when institutions are effective: that is, when they contribute to protect and enforce property rights and do not provoke distortions in relative prices, which therefore reflect scarcity and provide incentives to those engaging in entrepreneurial activities.

Unlike the contractarian approach, however, the historical view does not pay much attention to how the world should be, where it should be going or how its rulers should be selected or constrained. This does not deny that a social scientist – or any other human being – can have his own ideas on these issues. But it does mean that an opinion is not a theory and has little or no normative power. Opinions do not explain. If anything, they express personal preferences or informed guesses about risky or uncertain events. In fact, the analytical strategy suggested here focuses on identifying the axiomatic principles that keep a community together, the First Principles; and on explaining the sets of institutions and policy actions consistent with – and imposed by – those principles. It is surely interesting to detect and possibly quantify the consequences of those rules on aggregate or sectorial economic performance, a task that economic statisticians have been confronting for decades with increasingly sophisticated tools and

mixed success. From our standpoint, however, such exercises have an informative/documentary value, but little explanatory or predictive content[51].

Put differently, although it is not denied that we are living in an imperfect environment, the way the world changes and advances does not depend on the various categories of substantial and/or formal piecemeal solutions that social engineers might suggest. Progress hardly means better social goals or top-down improved meta-rules. Instead, the evolution in political structures and in the attitudes towards policy making depends on historical accidents and deep institutional changes, which in turn occur as a result of a combination of new ideological constructions, accidents (again), technological progress, decay affecting the previous set of First Principles. One might contend that this perspective smacks of relativism, since First Principles may evolve as a civilization moves from one historical period to the other. Or perhaps one can retort that First Principles remain the same, although the way they are acknowledged changes, thereby affecting human behavior and interaction. A typical example is the modification in the perception of the sacredness of property rights and the extent to which they can be legitimately encroached upon. Another example is the notion of punishment for criminal behavior, which in the past was often maiming and death, today is generally imprisonment or relatively mild constraints on the criminal's freedom to move.

Still, the role of the relativist debate within the present context should not be over-emphasized. It is of course true that all normative ambitions necessarily depend on the definition of First Principles, and that according to a large group of political philosophers these are not necessarily eternal. The very fact of continued disagreement on this question across time proves the point. Nonetheless, two additional aspects should be kept in mind. Those who raise the relativist question, no matter which answer they offer, are bound to develop their argument by accepting subjectivism as the basic operational principle of a community which, after all, are those typical of the individuals that create and maintain it. This holds true even when the reasoning is turned on its head, and it is claimed that a principled society is one that does not fall apart and offers a collective identity (a culture?) to its members. For even in this case the ultimate judge remains the individual. Thus, concentrating on the subjectivist debate is probably more relevant than coming to terms with relativism. Explanations require a

[51] The Austrian literature has already discussed at length these matters since its very inception (the *Methodenstreit*).

proper understanding of what communities do, of why they do it. That shows the importance of apprehending the belief structure with reference to which the members of a community operate, of clarifying what policy-making is expected to do, rather than focusing on what it ought to do in order to pursue an abstract goal (e.g. virtue, as the classical Greeks asserted, or peace, as Hobbes claimed, or consensus, as Hayek wrote).

To conclude, in the Western case neither relativism, nor Natural Law provides an *ex-ante* explanation of why the overwhelming majority of the Westerners are rather happy with the incumbent political structures[52]. The former is almost tautological, whereas the latter is either *ad hoc* (when in the Rousseauian sense) or simply remote from the current way of thinking (when in the Gregorian sense). As we have already seen, in the age of social responsibility individuals might not be all satisfied with the prevailing distribution of rents, or with the dominant redistribution patterns of income and wealth, but the presence and desirability of the rent-seeking activities is hardly questioned. The (democratic) procedure through which the rent-seeking structure is to be altered is also generally accepted. This does not imply that the present context is morally sound or coherent. Today's democracies are not a benevolent version of the Hobbes-Leibnitz version of the state[53]. The ruler's assurance of extensive rent-seeking weakly backed up by a legitimate threat of violence should the members of the community refuse allegiance is not a substitute for the 17th-century promise to pursue happiness (lack of conflict). Similarly, protection from (which actually means spreading) the cost of uncertainty and accidents is not the same as guaranteeing protection from physical violence. Still, even if those who believe in everlasting Natural Laws rightly maintain that these are violated, the substantial firmness of post WWI Western societies proves that the First Principles typical of the age of social responsibility are being complied with; moreover, the features and implications of such Principles are crucial when trying to understand the dynamics of norms in general and of normative economics in particular. Besides, the alternatives are not exciting: as will

[52] The emphasis on the need for *ex ante* explanations is not accidental, as it emphasizes the need to assess the connection between the set of shared preferences and beliefs (First Principles) that characterize a historical period and policy-making. On the other hand, *ex post* explanations are either no explanation at all (mere induction, instead), or they imply that facts, and facts only, affect and determine shared values – an extreme and somewhat distorted form of behaviouralism.

[53] See 'An unpublished manuscript of Leibniz on the allegiance due to sovereign powers', published in Riley (1972: 199-217).

be put forward in the next paragraphs, the contractual, the institutional and the evolutionary approach are of little help in explaining today's policy-making contexts.

On the contractarian shortcomings once again

Starting from Veblen, over a century ago the paleo-institutionalists[54] rightly held that both atomism[55] and holistic institutionalism are fragile starting points for economic theorizing. On the contrary, they maintained that the challenge for any economist (and social scientist, one might add) is to understand the nature and consequences of the rules of the game (institutions) on individual behavior. The individual, however, is not a *tabula rasa* where rules operate by creating incentive systems. Instead, he is a moral agent who reacts to outside stimuli following his perceptions, preferences and ideologies.

Unfortunately, although lip service is often paid to the paleo-institutional insights, their implications are almost systematically ignored. True enough, these classes of interaction are difficult to grasp, let alone to model or quantify. Still, difficulties do not justify oversight or outright blindness.

The contractarian view is no exception: its advocates are also deaf to the paleo-institutional lesson, with consequences. Earlier on it in this chapter has been shown that the contractarian solutions to the many imperfections of today's policy-making are less than adequate because they strive to legitimize the state through arguments that either rely on arbitrary consequentialism or on weak forms of utilitarianism. As a matter of fact, constitutional theories *stricto sensu* include both features: They ultimately validate restricted personal freedom and therefore government action, when this is perceived by the legislator as necessary to obtain the best of all possible worlds. The illusion of the human being tacitly signing the constitutional contract behind the veil of uncertainty *de facto* empowers the policy-maker to resort to ordinary law-making to pursue a goal that the veil makes sure nobody can really identify. In contrast, the quasi-minimal view does distance itself from consequentialism, but is nevertheless unable to overcome the

[54] This term has been effectively used by Adams (1994: 346) in order to single out those authors who drew attention to the dual origin of individual behavior: rational self interest dictated by preferences, which however mix with "ideas, values, rules of thumb, urges and misconceptions" when interacting in a social context.

[55] According to the atomistic vision individuals do react to social incentives. Such incentives do not, however, affect the agents' psychological patterns and preferences.

liberum veto problem[56] unless the ruler is endowed with the power to sidestep subjectivism. By doing that, however, some degree of discretion and utilitarianism must necessarily be accepted.

Last, but not least, all contractarian theories say very little about the interpretation of the social contract. If interpretation is subjective, then all contracts become a matter of good will and informal- or self-enforcement (as opposed to coercive enforcement). The state vanishes as a consequence. If interpretation is entrusted to a third party, then designation becomes a political question. It doesn't take much to fear that discretionary powers will be exploited to promote personal advancement and vanity (e.g. making the headlines), to pay political debts, or even to pursue one's honest belief about the real meaning of the constitutional covenant. In other words, the very tools that must be put in place to give the social contract operational content are the instruments that sink it. Recent examples along these lines abound in the American constitutional literature, which opposes those who believe that the Founding Fathers should be read as the authors of a document stating eternal and uninfringeable principles, with those persuaded that the Bill of Rights is a living text that acquires new meanings as time evolves and the notion of morality changes[57]. No matter who is right, there is no gainsaying the rules of the game prevailing in today's American politics are far from those the Founding Fathers had imagined over two centuries ago.

On the institutional temptation

[56] Beginning in 1652, the *liberum veto* gave each member of the Polish Diet the power to block legislation and paralyze the assembly. As reported in Dunn (1979: 74), recourse to *liberum veto* brought 90% of the Polish Diets to their knees, a particularly fateful experience when the circumstances required the ability to levy substantial funds to raise an army and keep foreign aggressors at bay, e.g. in the late 18th century. Of course, it remains to be assessed to what extent the Polish population always identified oppression with foreign annexation.

[57] The American case is in several respects unique. It can be considered the only surviving "Gregorian" document, in that it was conceived as a set of principles to protect individual freedom from government abuse. The democratic procedures prescribed by the American constitution were meant to ensure that those principles could not be overturned and, possibly more important, to give it strength and legitimacy through popular representation, without however giving the representatives much discretionary power. It is no secret that Congress initially had very little power and that its representatives did not enjoy much prestige.

As already mentioned in section 2., the American experience is in sharp contrast with most European Constitutions. Sometimes these were just a symbolic effort to mark a change in political regime and give legitimacy to the new rulers (or to the old rulers in new clothes). Sometimes they were a way to partition power among the various political groups under a (demagogic) cloud of wishful thinking. Not surprisingly, most of the time European constitutions actually present both features.

The institutional approach is probably more attractive, in that it escapes both consequentialism and utilitarianism, while offering a number of statements with which it is easy to agree: institutions matter, what happened in the past has an impact on individuals' present and future decisions, individuals sometimes take action to modify existing organizations or to create new agencies altogether, formal rules interact and sometimes conflict with informal rules. From the institutional perspective, change takes place in two forms: as a consequence of a shock (e.g. a war) or following a 'representational description', that is a situation where the conflict between informal and formal institutions forces the individual to wake up, abandon the ongoing smooth path-dependent process, and shape new beliefs. When this happens, the old rules of governing interaction with the institutional environment are disrupted and if a new system of social, economic, political variables consolidates, a new path-dependent context comes to the surface[58].

The major flaw in the institutional story is the fact that unless one crosses the border into determinism, it offers a description rather than an explanation. As a result, the nature of policy-making must necessarily be left out of the picture, since it is not conceived as the origin of institutional legitimacy. If anything, it is presented as the result of activities carried out by some organizations (including the state) that have been created by groups of individuals with the purpose of reducing transaction costs or of generating and exploiting rents, the only restraint being consistency with the prevailing informal rules. This is plausible when informal rules exist, are firmly in place and openly affect individual behavior, as exemplified in Ellickson (1991). But it is not very useful when informal rules do not exist (or are almost irrelevant, as it frequently happens in a world characterized by impersonal exchange/transactions), nor is it useful when rule-making is about redistributing income or regulating the relationship between the individual and the state (a citizen's duties and privileges), rather than among individuals. The latter case applies of course to policies in general.

By borrowing the institutional terminology, one could therefore refer to the features of our historical periods as to the institutions typical of the Old Institutional School. Nonetheless, the notion of path-dependence becomes all but useless, as it is now taken to identify the mechanisms through which, for each historical period, technology and ideology direct the main policy-making actors playing the game of

[58] Cf. Poirot (1993) and Fiori (2002) for critical surveys of these themes.

power and competing for power. The rest is a matter of accidents, no matter how important they might be. More important, and contrary to the (old) institutional argument, we maintain that institutions do not greatly affect individual perceptions[59]. Ideas/ideologies do. And when the rules of the game (institutions) run against those perceptions, then society cracks, loses its cohesion, perhaps falls apart while individuals revolt.

Is policy-making evolutionary?

How does our approach compare with the evolutionary approach? According to such view, economics should study how individuals adapt through production, consumption and exchange, led by their efforts to improve their conditions in the presence of variable rules of the game and scarcity[60]. In the past, the emphasis was on the role played by physical constraints (Malthus). Towards the end of the 19th century, more importance was devoted to men's way of thinking and to the established social relations (Veblen). More recently, the focus has moved towards the role of legislation and institutions widely understood: for instance, the free market system is one of the possible selection mechanisms, which forces agents to adapt and provides sets of incentives that direct people's actions and reactions, thereby creating a competitive process (Alchian).

All in all, even if mainstream economics maintains a different perspective, it is hard to disagree with the fundamental evolutionary argument: agents do not compete to maximize their happiness (or their profits). Instead, they adapt in order to improve their well-being or avoid worse conditions. The way they do so depends on their psychological patterns, on the behavioral routines inherited from the past, as well as on the characteristics of every human being (against the typical-agent assumption). This might lead to situations of conflict. Such situations, however, stem from the agents' efforts to survive or to improve their own condition. They are not necessarily a goal per se. When entering a new market or developing a new product, an entrepreneur aims at satisfying demand, not at exterminating incumbents.

---

[59] The institutionalists usually refer to behavior, a term which might however generate some confusion. We prefer to make a distinction between psychological patterns and behavioral routines. The former include the way reality is perceived and provide the guidelines along which the individuals' reactions to opportunities available unfold. The latter concern the way individuals actually behave given the biting constraints to which they are subject.

[60] See for instance Hodgson (1993).

Of course, these evolutionary statements are not denied here. Rather, the matter of contention regards the role played by culture (mental habits and systematic informal rules of social interaction). According to the evolutionary view, culture is subject to gradual change according to a path-dependent process, punctuated by accidents that can eventually alter its speed and direction. Thus, economic life would reflect the evolving nature of culture and scarcity (technology, demography). Nonetheless, the border between description and explanation appears thin, for unless one has a theory of cultural path-dependence, social interaction and its developments can only be 'explained' *ex post*, which is indeed what happens when one describes. As a consequence, and quite understandably, the evolutionary school has little to say in terms of policy-making, other than claiming that there is scope for intervention whenever the cultural legacy leads people to behave inefficiently[61], and at the same time warning the rule-maker about the potential damages provoked by the introduction of formal rules that run against the prevailing informal environment.

As a matter of fact, we do not object to the evolutionary (and paleo-institutional) notion whereby ideologies shape social interaction and affect social dynamics. However, we also claim that the ideological framework does not evolve, but is simply subject to a very limited number of deep changes, a selection mechanism operates, one which is driven by the quest for power and constrained by the current technology. The evolutionary school defines a stable regime as a situation resulting from repeated actions that have proved successful through time, but which continues to be subject to gradual and continuous change. In fact, stability as commonly understood is ruled out almost by definition. Instead, according to our historical perspective, within each historical period stability means constant psychological patterns in accordance with the First Principles of the time, which by definition remain fixed within each period. Interactions might change behavioral features, of course, as a result of new technological opportunities, which sometimes expand the range of possible individual choices, sometimes increase the scope and opportunities for additional policy-making.

[61] This is indeed Veblen's view, which is not necessarily shared by other evolutionary scholars. They might deplore the way people adapt, but they do not necessarily advocate rule-making as a way to interfere with the choices driven by the evolutionary principles mentioned in the text. At most, they fall back on the minimal institutional position, whereby policy-making is good whenever it reduces transaction costs without violating the Pareto-optimality conditions (no member of the community must result worse off as a result of the policy measure). The verdict remains ambiguous when the individuals negatively affected by the policy measure are worse off because intervention has reduced or eliminated their rents.

Nonetheless, feedbacks on the ideological structure are moderate or altogether absent, since the structure remains dominated by the last deep institutional change[62].

Hence, culture does matter, in that it can be claimed that First Principles define the cultural environment, which amounts to saying that culture counts if one defines this concept as the content of the deep institutional change. And there is no doubt that a community can go through cultural changes. For instance, we conjecture that the West went through three such changes. Similarly, one can make the case for different societies or civilization featuring different cultures, since one presumes that not all societies underwent the same deep institutional change.

But it can also be maintained that culture does not count (much) if one regards it as a system of steady, resilient behavioral patterns dictated by tradition, established informal rules and habit. One can surely observe that people do follow informal rules, but there is no doubt that those informal rules are quickly abandoned when they do not work, or when they become an impediment to obtain higher levels of well-being. An example is provided by generations of immigrants or, more recently, by how quickly young people in post-communist countries have adopted 'Western values'. Similarly, one can definitely observe habits, such as the use of monetary means of exchange or language. But these can hardly be called 'culture' in an evolutionary sense: money is not used because our ancestors used it, but because it is useful and its use makes nobody worse off[63]. In fact, as soon as the technology allowed for new means of payment (e.g. plastic cards with a magnetized strip) many individuals rapidly reduced their use of bills and coins. Similarly, we do not speak a language because our ancestors spoke that idiom, but because that is what our parents taught us and because we find it more difficult to express ourselves in other languages. But there is of course no cultural barrier that prevents millions and millions of people from learning another language in order to make sure that others understand what they are saying or read what they are writing (or vice-versa).

---

[62] Of course, this does not deny that technological progress might spark new moral debates (e.g. on cloning). But these hardly lead to major shifts in the psychological patterns. Although exceptions are ubiquitous, different attitudes generally reflect differences in opinions, not in First Principles.

[63] One might object that the introduction of paper money by the state implies some kind of violence, for the term 'legal tender' actually implies that nobody can refuse legal tender as a means of payment. This constraint can, however, be bypassed with relative ease in free capital and goods markets and needs not be pursued further.

To conclude, we posit that evolutionary economics offers rather limited help in understanding the nature or the foundations of policy-making. Surely, it emphasizes the role of the social environment and predicts that policies evolve according to the way accidents affect – and generate routines that are ultimately incorporated into – culture. Yet, we do not believe this to be enough and we therefore make a different point. That is, we maintain that successful policy-making is about gathering consensus on a fixed set of issues defined by the last deep institutional shock. One can of course discuss about how deep a deep institutional shock is; or how large consensus must be in order to define First Principles. That is indeed today's challenge for the policy maker, who might have to look for new ways and identify a new agenda to bolster consensus, should the features of the current historical period weaken.

6. A program for (hard) empirical work

To repeat, our perspective considers historical periods as characterized by the fact that given rules of the game are more or less accepted by the members of a community thanks to a system of shared social postulates, if not ideologies. In each period, such members might not like the ensuing political outcome and might want to have a better system, a better ruling elite, or both. But within each period neither the exercise of power nor the boundaries of power are seriously questioned. With very limited exceptions, not even the procedure to select the ruler is an issue.

In particular, during the age of social responsibility, the prevailing ideology (First Principles) has accepted top-down policy making for the sake of peace, qualified power sharing extended rent-seeking, and reduced individual responsibilities within the economic domain. Hence, it is apparent that a society can break down when the rulers are manifestly incapable of avoiding turmoil and/or unable to provide satisfactory opportunities for rent-seeking and/or ask its members to be economically responsible. Put differently, as long as individuals share the First Principles typical of the age of social responsibility, rule-makers confronting a crisis will make the 'right' decision in coming to the rescue of those who suffer most, in making sure that major shocks are avoided, in making promises guaranteeing a soft landing should further disturbances occur. The very fact that these policies make little economic sense is of course irrelevant, for in the age of social responsibility there is little room for efficiency and

other textbook criteria (e.g. moderate taxation, little redistribution, concerns for long-run effects such as inflation and moral-hazard).

Reactions to an economic emergency from a (new) contractarian standpoint would be different, for in this context a crisis is actually irrelevant. In the constitutional situation, policy-making should respect the veil of uncertainty, behind which people have ruled out rent-seeking and redistribution. As a result, the principle of individual responsibility is protected and collective goods only are produced. Failure to do just that would imply a violation of the social contract and therefore elicit overt hostility towards the rule makers. The quasi-minimal version would lead to a similar conclusion, with two differences: the Paretian constraint would ensure that the production of collective goods is smaller and – more importantly – legitimate policy-making would not be driven by consensus or (democratic) majorities, but by Paretian straitjackets and thus explicit-consensus guidelines. It then follows that while the Constitutional contract has both a (strong) normative and a (mild) explanatory goal, the quasi-minimal contract is merely prescriptive, and thus hardly suitable for empirical verification[64].

We believe that the institutional approach is better suited to undergo empirical scrutiny. In particular, two theses can be verified. One regards the possibility of institutional change taking place as a consequence of a path-dependent process driven by pressure to lower transaction costs. In other words, the institutional argument is that institutions evolve because technological progress creates new situations and these require new organizational arrangements. Although data gathering may present significant empirical and methodological challenges, the economic statistician should investigate whether transaction costs per unit of exchange (or their weight out of values exchanged) actually follow some kind of monotonic process[65], controlling for (i) the increases in productivity provoked by better technologies (rather than by better institutions), (ii) the fact that as time goes by more and more transactions (and

[64] The explanatory power of a social theory depends on whether the theory is about what rule-makers do, or about what they ought to do. The quasi-minimal contract clearly falls in the latter category. It therefore surrenders all explanatory ambition and should therefore be considered just as a definition of good government and possibly as a benchmark for evaluation. The constitutional contract can be applied for explanatory purposes as long as it accepts democracy as the proper procedure to conceive and enforce the rules. Its 'mild' explanatory power is due to the ambiguities of the constitutional school with respect to democracy. Some authors accept it (e.g. Hayek, Buchanan and Vanberg), others qualify their endorsement or have second thoughts (e.g. Hayek 1979, who draws a distinction between democracy and "demarchy".

[65] Efficient path dependence would suggest that the trend should be declining, but some caution is in order, for path dependence is not necessarily virtuous.

transaction costs) are observed just because lower transaction costs make exchange affordable and thus feasible, (iii) the fact that many transaction costs are not observed and thus are hard to quantify[66].

The second institutional concept open for investigation refers to the occurrence of institutional change or conflict following acute friction between formal and informal rules, as long as formal rules are relevant, i.e. enforced. This kind of exercise, however, also presents significant problems. For instance, one must differentiate between those tensions generated by formal rules at odds with the informal rules and those created by simply bad (inefficient) rules. The former would provoke a cultural crisis and a systemic shock, whatever these terms means; the latter would simply require a change in the legislator, or in the incentives that drive the legislators' activities. In some cases, drawing the distinction may be easy; in most cases, it might be quite difficult and identification problems might arise. Possibly more relevant from a theoretical standpoint is the informal/cultural question.

In order to have a conflict between formal and informal rules, one must have resilient informal rules. The early institutional view held that informal rules come first, while good formal rules would and should add transparency, publicity and credibility to sets of agreement based on shared, consolidated values (culture). Hence, formal rules contradicting informal rules would simply be bad rules, which would be amended or would lead to turmoil, as mentioned above. More recently, however, it has been observed that informal rules take time to form and pass the filter of habit and tradition. Nonetheless, technological progress is so fast that it often makes behavioral patterns obsolete even before they become stable, shared routines and thus real informal rules. Thus, in today's societies, standardized behavior never succeeds in becoming an informal rule. And formal rules no longer fulfill the role of codifying informal rules; rather, they anticipate the informal rules that would eventually develop, if those patterns had time to go through the time-filtering process. Hence, one might have second thoughts about considering the tensions between formal and informal rules. If so, the potential for conflict then arises when the incentive structures and perceptions generated by technological progress are found inconsistent with the sets of formal rules introduced

[66] Qualifications (ii) and (iii) explain why the results of the current efforts to quantify the size of transaction costs might be questionable. See North (1994), according to whom transaction costs account for about 50% of GDP in a modern economy.

by the legislators. This includes policy-making of course. Once again, designing reliable experiments that take these issues into proper account and distinguish the historical hypothesis from the institutional argument (First Principles and ideologies are more powerful than incentive structures in shaping individual perceptions) is not impossible, but is hardly amenable to the current statistical techniques of which economists seem to have grown particularly fond.

Finally, testing the evolutionary approach to policy-making is equivalent to testing the role that an evolving culture plays in determining the nature of state intervention. In particular, the analysis should investigate and compare the changing nature and driving forces of policy-making as culture dictates new requirements and constraints. That implies that such changing nature and driving forces be identified, and that long-term policy trends be cleansed of short-term expedience. Once again, technological opportunities should also be taken into account, since their presence can potentially generate new evolutionary paths, thereby requiring updated rule-making approaches. Of course, the historical view would simply maintain that there is no substantial change within each historical period (other than those provoked by the new technological conditions). Hence, both the evolutionary and the historical approaches would predict somewhat variable and possibly erratic policy-making. The difference, however, is the question of origin. According to the former view, policy-making is just the result of more or less rapidly changing cultural patterns driven by expanding, technologically-driven sets of opportunities. Still, clear trends should be discernible, with differences across countries or geographic areas. According to the latter view, policy-making consists of a set of *ad hoc* measures that follow accidental events, normally have a short-term horizon and tend to expand the rule-makers' power without alienating consensus. The tools are diffused rent-seeking and universal access to privileges.

References

Adams, John (1994), "Economy as instituted process: change, transformation, and progress", **Journal of Economic Issues**, 28 (2), June, pp.331-355.

Bennett, Robert (2003), **Talking It Through. Puzzles of America Democracy**, Ithaca and London: Cornell University Press.

Berman, Harold (1983), **Law and Revolution**, Harvard University Press.

Brennan, Geoffrey and James Buchanan (1985), **The Reason of Rules**, Cambridge: Cambridge University Press.

Buchanan, James and Gordon Tullock (1962), **The Calculus of Consent**, Ann Arbor: University of Michigan Press.

Commons, John R, (1924), **Legal Foundations of Capitalism**, New York: The Macmillan Company.

Dewey, John (1934), **A Common Faith**, New Haven: Yale University Press.

Dougherty, Jude (2000), **Western Creed, Western Identity**, Washington D.C.: Catholic University of America Press.

Dunn, Richard S. (1979), **The Age of Religious Wars 1559-1715**, second edition, New York: Norton & Co..

Dworkin, Ronald (1986), **Law's Empire**, Cambridge (Ma): Belknap Press.

Ellickson, Robert, **Order without Law**, Cambridge (Ma.): Harvard University Press.

Fiori, Stefano (2002), "Alternative visions of change in Douglass North's new institutionalism", **Journal of Economic Issues**, 36 (4), pp. 1025-1043.

Hayek, Friedrich von (1960), **The Constitution of Liberty**, Chicago: The University of Chicago Press.

Hayek, Friedrich von (1979), **Law, legislation and Liberty – The Political Order of a Free People**, Chicago: The University of Chicago Press.

Harnay, Sophie, Alain Marciano (2207), "Intellectual property rights and judge-made law", in D. Porrini and G.B. Ramello (eds.), **Property Rights Dynamics**, London and New York: Routledge, pp. 198-218.

Hodgson, Geoffrey (1993), **Economy as Evolution: Bringing Life back into Economics**, Cambridge: Blackwell Publishers.

Hohfeld, Wesley Newcomb (1923), **Fundamental Legal Conceptions as Applied in Judicial Reasoning: and Other Legal Essay**, New Haven: Yale University Press.

Holcombe, Randall (2004), "Government: unnecessary, but inevitable", **The Independent Review**, VIII (2), Winter, pp. 325-342.

Jasay, Anthony de (1992), **Choice, Contract, Consent: a Restatement of Liberalism**, London: Institute of Economic Affairs.

Koselleck, Reinhart (1979), **Vergangene Zukunft. Zur Semantik Geschichtlicher Zeiten**, Frankfurt/M.: Suhrkamp Verlag.

Kühnel, Martin (2001), **Das politische Denken von Christian Thomasius**, Berlin: Duncker & Humblot.

Lewis, Clive S. (1944), **The Abolition of Man**, reprinted in 2001 in New York: HarperCollins.

McGinnis, John and Michael Rappaport (2007), "Majority and supermajority rules: three views of the Capitol", **Texas Law Review**, 85(5), April, pp.115-1183.

Nicita, Antonio (2007), "On incomplete property", in D. Porrini and G.B. Ramello (eds.), **Property Rights Dynamics**, London and New York: Routledge, pp. 77-90.

North, Douglass (1994), "Economic performance through time", **American Economic Review**, 84 (3), June, pp. 359-368

Poirot, Clifford S. (1993), "Institutions and economic evolution", **Journal of Economic Issues**, 27 (3), September, pp. 887-907.

Rawls, John (1971), **A Theory of Justice**, Cambridge (Ma.): Harvard University Press.

Riley, Patrick (ed.) (1972), **Leibniz - Political Writings**, Cambridge: Cambridge University Press.

Weingast, Barry and Donald Wittman (eds.) (2006), **The Oxford Handbook of Political Economy**, Oxford: Oxford University Press.