

CHAPTER 8

final

THE SOURCES OF ORDER AND DISORDER¹

Economists seldom put the problem of order and disorder at the center of inquiry. Historical- and contemporary--experience suggests that they should. Establishing and maintaining social order in the context of dynamic change has been an age old dilemma of societies and continues to be a central problem in the modern world. The reason is straightforward. Economic change produces changes in the absolute and relative income, economic status, and security of individuals and groups in a society and therefore is a breeding ground for disorder. Disorder (via revolution for example) is endemic to all societies at some in time; but while some societies recover to reestablish stable order, in others disorder persists for long periods of time and even when order is reestablished its survival is extremely fragile. The persistence of disorder is, on the face of it, puzzling because disorder increases uncertainty and typically the great majority of players are losers. It is not so puzzling when perceived in the context of human consciousness. Beliefs, both positive and normative, are at the heart of consciousness. We have not only a vision of the way an economy and society is working but a normative view of how it should be working and views about how it could be restructured to work better. Thus consciousness can lead to the construction of a set of beliefs that induce players to believe that revolution is a preferred alternative to a continuation of what is perceived as a deteriorating condition. At the other extreme,

consciousness can lead to the construction of a set of beliefs in the “legitimacy” of a society. What we shall explore in this chapter is under what conditions beliefs get activated to produce order and disorder.

I

Order is a necessary (but not sufficient) condition for long run economic growth. It is equally a necessary (but not sufficient) condition for the establishment and maintenance of the variety of conditions that underlie freedom of person and property that we associate with a consensual or democratic society. Therefore improving our understanding of the fundamental sources of order and disorder as well as the transition from one to the other is necessary for understanding economic change.

Order can be established and maintained via an authoritarian rule without the consent of the governed or it can be established and maintained via consent of the governed. I can describe ideal types of each as follows:

Authoritarian political order ideally exists when the participants find it in their interest, given their expectations about the actions of others, to obey the written or unwritten rules specified by the ruler. Conformity is usually attributed to some mixture of coercive force by the ruler and social norms such that individuals find it in their interest to behave in ways conducive to the existing social order. A common belief system which embodies social norms consistent with the policies of the ruler will reduce the use of coercion; and conversely, diverse belief systems or a common belief system at odds with the policies of the ruler will increase the ruler’s reliance on coercion.

Consensual political order exists ideally when the participants find it in their interest, given their expectations about the actions of others, to obey the written or unwritten rules that call for respect for

¹ This chapter is largely derived from an essay by Douglass North, William Summerhill, and Barry Weingast entitled “Order, Disorder and Economic Change: Latin America versus North America” in (2000) Governing for Prosperity

one another. Conformity is usually attributed to the internalization of social norms so that individuals want to behave in ways conducive to the existing social order and/or social control, which is exercised over potential social deviance by others. Shared mental models reflecting a common belief system will translate into a set of institutions broadly conceived to be legitimate.² This requires that, in equilibrium, all members of society have an incentive to obey and enforce the rules and that a sufficient number are motivated to punish potential deviants. The rules are binding providing, first, that the same people play the same game with the same payoffs and risks; and second, that the uncertainties about the future remain constant.³

Both systems of order ideally have the following characteristics:

1. an institutional matrix that produces a set of organizations and establishes a set of rights and privileges;
2. a stable structure of exchange relationships in both political and economic markets;
3. an underlying structure that credibly commits the state to a set of political rules and enforcement that protects organizations and exchange relationship;
- 4 conformity as a result of some mixture of norm internalization and coercive enforcement.

The two types are at opposite ends of the spectrum of political organization and are seldom, if ever, realized in their pure form. Authoritarian rule can, and does, vary, from Josef Stalin terrorism to the “Singapore” model; and consensual order can vary from the direct democracy of some Swiss Cantons to the de facto single party rule that has characterized Mexican political order over the past

edited Bueno de Mesquita, B. and Root, H. New Have: Yale University Press.

² See Denzau and North (1994) for an elaboration of the cognitive science foundations of this argument.

³ See Randall Calvert, “Explaining Social Order: Internalization, External Enforcement, or Equilibrium?” GET CITE for a game theoretic modeling of the issues which illumines a number of critical issues in the establishment and maintenance of order.

decades. The important point that this comparison stresses is that order reduces uncertainty and therefore has some common characteristics that are considered a “good” in themselves and individuals and groups in society have frequently knowingly accepted authoritarian order in preference to disorder. A second point is that authoritarian and consensual rule tend to blend into each other in the middle of this spectrum where some mixture of coercion and social norms are the basis of order. Indeed since coercion is an essential part of consensual political order where decision affecting the members of a society are effected by less than unanimity of the members, coercion and force are an integral part of such societies. The key difference is the extent to which decision makers are constrained by the formal and particularly the informal constraints in the system.

Disorder increases uncertainty because:

1. rights and privileges of individuals and organizations are up for grabs implying disruption of existing exchange relationships in both political and economic market;

2. conformity disappears as a result of either disintegration of norms and/or change in enforcement.

With this background I shall first of all explore the origins of disorder in economic change (II), and then go on to explore the stability conditions for the maintenance of order with economic change(III). I shall illustrate each of these with an extended description first from United States economic history illustrating disorder and then recovery to stable order (IV) and contrast that with Latin American economic history in which revolution is followed by prolonged disorder (V).

II

Disorder can emerge as a result of changes which lead to a reduction of coercive enforcement of rules or of the weakening of norms of cooperation which induce organizations to attempt radical changes in the rules of the game. One kind of change is an event that dislodges the old mechanisms that provided credible commitment in society without providing adequate substitutes. Examples of such events include the demise of a (authoritarian) ruler, but often they reflect a crisis that allows a sudden turnover in political power by groups who seek major political change. Crises may dislodge the old order in any of several ways. For example, an economic crisis limiting the resources that can be distributed may persuade some erstwhile supporters of the regime to oppose it, thereby destroying the consensus supporting the regime.

Another kind of change can arise from a set of incremental changes that persuade some individuals and groups that revolution is a lesser risk than a continuation of the incremental changes which are perceived to threaten the survival of one group. De Figuerido and Weingast (1998) summarize the steps in this process as follows:

1. A set of political entrepreneurs articulate a new set of beliefs in fundamental conflict with the existing order--beliefs that are held, at first, only by a small minority.
2. The opponents of these entrepreneurs act in ways that make these ideas appear to be true, thus confirming the revolutionary beliefs in the eyes of the pivotal players. Thus events beyond the direct control of the new ideas proponents occur that lend some credence to these beliefs.
3. The result is a spread of the beliefs to some of the pivotal decision makers. When the pivotal decision makers accept the radically new beliefs, they provide sufficient political support for radical action.

The maintenance of order over long periods of time and the rapid reestablishment of order when a society does undertake radical change have distinguished societies like the United States from most of those in world history. Over the past three and one half centuries the United States has maintained a system of order with economic change including rapid recovery from a revolution gaining independence from England and one of the most devastating civil wars in history. Moreover the economic growth that has occurred over this period has radically altered the incomes and status of groups in the society. What I have described elsewhere (North, 1990) as adaptive efficiency characterizes societies in which the flexibility of the institutional matrix adjusts to resolve problems associated with fundamental economic change. Let me state four propositions for the maintenance of political order in the face of economic change that can give us some insight into adaptive efficiency.

The first proposition concerns the relationship of a shared belief system about the legitimate ends of government and the rights of citizens. All rights accorded to citizens--whether personal, economic, religious, civil, or political--imply limits to the behavior of political officials. The key to political order is the establishment of credible bounds on the behavior of political officials. Citizen rights and the implied bounds of government must be self enforcing for political officials in that transgressing them would jeopardize a political leader's future. The creation of a shared belief system in a society reflects the development (usually over a long period of time) of social norms with respect to the legitimate limits of behavior of political officials

The second proposition holds that successful constitutions limit the stakes of politics in part by assigning citizen rights and other limits on government decision making.

The third proposition states that property and personal rights must be well defined so that it is evident to citizens when these rights are being transgressed.

The fourth proposition holds that the state must provide credible commitments to respect these rights thus providing protection against opportunism and expropriation by public officials.

Underlying these propositions is an institutional matrix that not only specifies these conditions in the formal rules but equally important is undergirded by strongly held social norms that imbed these values into the culture of the society. This cultural conditioning of a society usually takes place over generations and is a fundamental reason for the difficulty of establishing stable consensual order in societies that have experienced persistent disorder. In such cases authoritarian order may very well be the lesser evil to be preferred by the members of that society.

IV

American political, social, and economic history has been characterized by relative stability in the colonial era up to the end of the Seven Years War, instability and then revolution until 1781; the reestablishment of order and rapid economic development to be interrupted again by Civil War between 1861 and 1865; and then the relatively rapid reestablishment of order and revival of economic growth that persisted thereafter. In what follows I shall briefly outline the main contours of this story in terms of the analytical framework advanced above.⁴

First, the British Empire of the eighteenth century had multiple levels of government, each with its relatively well defined sphere of authority. Until the end of the Seven Years War in 1763, the British

⁴ This account is drawn from the essay referred to in footnote 1 of this chapter. A longer and more detailed account can be found in Rakove, Rutten, and Weingast, (1998)

role in North America was limited to empire-wide public goods, notably security and international trade. Colonial assemblies, working with the British governor, held broad authority over local public goods, property rights, religious freedom, and contract enforcement, subject to some constraints of British law. Second, the institutions of the empire placed considerable constraints on the British role within the individual American colonies. Third, British institutions created a common market within the empire, preventing individual colonies from raising trade barriers.

The pervasive French threat bound together both sides of the Atlantic in a relationship based on common interests. Because both sides needed each other, they were able to create and adhere to a system of political and economic autonomy inherent in empire's federal structure. Although each side might be tempted to cheat, both sides found the empire's federal structure convenient. Indeed the strict line between the system wide issues of trade and security and all other domestic issues within the colonies (such as religious freedom, taxation, property and social regulation) created a "bright-line" credible commitment mechanism. In this system, deviations by either side were easy to detect. In terms of the four propositions for consensual political order, the empire's federal structure created a natural focal solution, making actions easy by either side to police.

Over the one hundred years prior to 1763, the British came to accept local political freedom in exchange for the colonist's acceptance of British control over the empire, including trading restrictions on the colonists. The institutions of the empire combined with the shared belief system supporting these institutions together underpinned cooperation from both sides of the Atlantic.

In the dozen years following the close of the Seven Years War, controversy and crisis emerged, ending in the revolution. The principles discussed above provide a framework to understand the emerging disorder.

Various changes in British policy toward the empire after 1763 threatened this system. Three were critical. First, although the war removed the French threat, it did so at a huge financial price, leaving Britain with the largest debt ever. The British naturally turned to the colonies to finance a portion of the debt. Second the French defeat greatly changed the empire. Prior to the defeat, the American colonies represented a major portion of the empire. Anything that hurt the American colonies hurt the empire. After the Seven Years' War, this was not necessarily true. In the new and much larger empire, the British might reasonably design empire-wide policies to govern the system that might harm one part. Following the French defeat, American had much less need for the British security umbrella and thus less reason to conform to British interests.

These changes led many Americans to conclude that Britain would no longer observe the principles of federalism within the empire. This view was especially strong among the emerging radical group. This group argued that the precedent of the British directly intervening in colonial affairs through taxes meant the end of liberty, including the end of autonomy for colonial assemblies, and hence all that the colonies held dear. With this precedent established, the group went on to say, the British could alter other policies at their discretion. In the beginning most Americans paid little attention to the radicals, where noise about liberty seemed not to ring true. The British had yet to provide much cause for believing that they intended major policy changes. Further, moderates and opponents both feared that the alternative to British rule was worse. But the succession of policies of the British from the request that the Colonies provide for the quartering of British troops in 1766 to the Tea Act of 1773 induced strong reactions in the Colonies and provided striking evidence to support the radicals. As the radicals suggested from the beginning, the new British policies threatened American liberty.

In short the sudden emergence of disorder in America reflected the principles articulated above. The defeat of the French helped dislodge the old system, leading to changes in British behavior and policy within the Empire. In reaction, American radicals articulated a new idea, one at first on the fringe of American beliefs, namely that the British actions represented the end of liberty. Early on the controversy with Britain, the politically pivotal moderates disagreed with the radicals. Yet British actions provided evidence (in the sense of Bayesian updating) in favor of these ideas causing them to gain support among the pivotal moderates and by 1775 the moderates had switched sides to support the radicals in revolution against the British.

The reemergence of order after the revolution was fundamentally dependent on the heritage of the colonial era. The set of political and economic rules of the game that were established with British rule provided for self-government of the colonies and well specified property rights in the economic sphere. While there is no intention to minimize the controversies that swirled around the era of the Articles of Confederation and the establishment of the Constitution, the foundations of stability of political and economic rules were carried over to independence from the colonial charters. The principles of political order discussed above were reflected in the way the Constitution lowered the stakes of national political action in a variety of ways, including a complex system of enumerated powers, a separation of powers system, and a system of federalism placing striking limits on the national government. The debates during this era served to provide a new shared belief system about the bounds on the national government and the importance of citizen rights and state autonomy.

Competition among the states in the face of a growing common market gave states the incentive to foster a favorable economic climate, and the presence of a hard budget constraint greatly limited the ability of the states to subsidize local economic agents. Citizens in the early American republic favored

freedom for state and local governments and thus strong limits on national government. The widely held belief system combined with the political institutions, property rights, and law produced a system highly favorable to decentralized competitive markets. When the system was combined with the favorable factor endowments that the country inherited the result was rapid economic development.

The Civil War was a terrible disruption in the nineteenth century history of the United States brought on by a breakdown in the political stalemate that had preserved the Union through growing political, economic, and social conflict between the North and South. In effect the mechanisms that had provided credible commitment to both sides disappeared with that breakdown, thereby convincing Southern states that secession was the only viable alternative.⁵ The War was one of the most devastating in history but the remarkable feature in terms of the subject of this chapter was the extraordinary recovery. Within a few years after the end of the War economic growth was renewed in the North and before the end of the century in the South as well even though the end of reconstruction in 1877 resulted in perpetuation of second class citizenship for African Americans through much of the twentieth century. But political, economic, and social order did ensue and produced not only sustained economic growth through that century but via political and social institutional change dramatically improved the status of African Americans as well.

The adaptively efficient institutional structure that has characterized the American economy is a consequence of path dependence (the political and economic institutions inherited from British rule), favorable factor endowments (boundless rich land and resources, immigration of labor and capital from Europe), endless favorable events throughout the nineteenth century that reinforced the belief system

⁵ For a more detailed analytical account see Barry Weingast, "Political Stability and the Civil War: Institutions, Commitment, and American Democracy" in R. Bates et al, Analytical Narratives, 1998, Princeton University Press.

that supported the formal political and economic institutions (such as the widespread discovery of gold at the end of the nineteenth century which produced prosperity for agriculture after decades of discontent), and good luck (the anti-federalist boycott of the Constitutional convention for example). One critical fact should be emphasized. The heritage of British institutions created a favorable milieu for the development of the institutions of impersonal exchange which was the foundation of the long term economic growth of the American economy.

V

The Latin American story starts with Spanish (and Portuguese) colonization of the new world but the similarities with the north disappear right away. The entire pattern of settlement, trade and development was geared to the extraction of precious metals for the Crown. It was an authoritarian system ruled from Madrid. Neither self-government nor competitive markets existed. The Crown granted exclusive monopoly privileges to selected merchants and trade was confined to a small number of ports in the whole of South America. The objective of the Spanish mercantilist structure was to implement the movement of precious metals to Spain not to promote the development of Latin America. Such a pattern of settlement and extractive structure had profound implications for Latin America after independence.

Napoleon's imprisonment of the Spanish King in 1807 led to efforts to redefine the colonist's relationship to the metropolis and initiated the outbreak of independence movements throughout Spanish America. The defeat of Spanish armies resulted in the fragmentation of the former colonies into new republics many of which adapted a version of the United States constitution as a model for independence. But the consequences were radically different. Without the heritage of colonial self

government and well specified property rights, independence disintegrated into a violent struggle among competing groups for control of the polity and economy. In most of Spanish America it took a half century for one of the competing groups to emerge victorious. Establishing order became a goal in itself thus creating and perpetuating authoritarian regimes—the phenomenon of “caudillismo” became pervasive.

The demise of the colonial system raised new conflicts that the newly created states were unable to resolve. Attempts to create new republican institutions (U.S. inspired constitutions) clashed with the political foundations of the old order. Under the royal system, rights were granted to individuals and groups based on personalistic ties to the crown. The result was huge land grants to wealthy individuals and the church; rights and privileges to the military; and a series of local monopolies in production and trade. Self government was completely absent. Personal ties dominated political and economic exchange. With independence deep political conflicts emerged with those who had inherited rights from the royal regime in fundamental conflict with the republican institutions and consequent organizations that evolved with independence.

The discussion of sources of disorder described above gives us a handle to understand the Spanish American ex-colonies after independence. There was no shared belief system about the role of government, the state, corporate privileges, and citizenship. There was, however, a common set of beliefs built on personal exchange which fostered strong personal relationships but undercut the construction of institutions of impersonal exchange. The absence of consensus about the legitimate ends of government and how society should be organized resulted in failure to police limits to the state. The absence of agreement about basic political structure combined with an absence of a shared belief system resulted in an absence of credible commitment by the new states and inherent political instability.

Yet inherent political instability did not completely halt economic growth. In Latin America it produced neither economic collapse nor stagnation but continuing instability, extensive rent seeking, political authoritarianism, adverse income distribution, and an inefficient provision of public goods, but still (slow) economic growth. In Mexico, for example, vertical political integration consists of a coalition of government, asset holders, and a third party that could credibly commit the parties to uphold agreements. While the third party could be a foreign state, in Mexico it was a domestic group whose support was essential to the government and who derived rents from the asset holders. The result was not a universal protection of property rights but a selective protection confined to the relevant asset holders.⁶ While this story is specifically focused on Mexico the account has wide applicability not only to Latin America but with variation to much third world history. The important point being made is that it cannot be in the interest of politically dominant groups to stop all growth since it dries up the sources of income. What Mancur Olson has described as the stationary bandit model is one in which such a player has an essential stake in not confiscating all of the net income of asset holders.⁷

Two centuries after independence the historical contrast between North America and Latin America continues to provide the underlying basis for the contrasting performance. The United States retains a robust system of federalism, democracy, limited government, and thriving markets. Much of Latin America is still characterized by stop and go development, fragile democratic institutions, questionable foundations of citizen rights, and monopolized markets.⁸

⁶ See Stephen Haber, Armando Razo, and Noel Maurer, The Politics of Property Rights: Political Instability, Credible Commitments and Economic Growth in Mexico, 1876-1929 (Cambridge University Press, forthcoming).

⁷ Martin McGuire and Mancur Olson, "The Economics of Autocracy and Majority Rule: The Invisible Hand and the Use of Force", Journal of Economic Literature, March 1996, pp 72-96

⁸ Nowhere is this fragility better illustrated than in the history of Argentina—a country with the 6th highest income per capita in the world in 1940 and then stagnation for more than forty years followed by brief revival and (as of this

Some of the contrasting performance can be traced to standard factor endowments analysis from neo-classical economics. Endowments were clearly a driving force in the pattern of European colonization. But the endowments argument must be fundamentally supplemented by the powerful consequences of the path dependent results of colonial inheritance, the institutions of slavery and the *encomienda* system, and contrasting institutional evolutions that occurred as a consequence of this blend of economic and institutional forces over the two centuries. The source of these contrasting institutional patterns were the fundamental beliefs of the key players in each case. The evolution of the belief system in Britain will be explored in chapter 10 below. That belief system carried over to the American colonies provided the basic source of the adaptively efficient institutions that evolved. In contrast, the beliefs underlying the institutions promulgated by the Spanish crown have, to this day, provided two centuries of instability, turmoil, and limited development.

writing) economic collapse. For a discussion of the sources of erosion of Argentine prosperity see Lee Alston and Andres Gallo, "The Erosion of Legitimate Government: Argentina, 1930-1947" (Working Paper, December 2001).