

Understanding the foundations of all political systems: leadership, law, and local government
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Social scientists need to try to understand as much as possible about the essential foundations of successful economic and political systems. By studying many different systems throughout history, we can try to discover some of the universal principles that underlie all successful political systems. In this paper I will summarize what I have learned about the fundamental issues related to successful systems by applying basic principles of economic theory to the history of political institutions in England and America. I will consider the development of four important institutions in English and American political history: the medieval Court of the Exchequer, the English common law, the English Parliament, and the American system of federal democracy. I will then make some comparisons to the political history of China. I will argue that the relationship between local governments and the national government is vital to the success of all great nations.

The Court of the Exchequer

If you study the history of political institutions in England, you will find that historians note in particular the vital importance of the Court of Exchequer to the early development of the English monarchy around 1200 (Warren, 1973, ch 6-8). Today the Chancellor of the Exchequer is the finance minister in Britain, so you may guess this medieval Court of the Exchequer had something to do with money or the economy, but actually the Court was central to the entire government of England. A manuscript from 1180, the *Dialogue of the Exchequer* by Richard FitzNigel, explains how the Exchequer worked in this early period and why it was so important.

The Exchequer got its name from the fact that it had a checkered table cloth on which tokens were placed in keeping track of financial transactions of the English monarchy. But FitzNigel tells us that, as at a game board for checkers or chess, there was a contest at the table -- a conflict between two individuals. To begin to understand the foundations of successful political systems, we need to understand: Who were the two parties in conflict around the table at the Court of the Exchequer, and why was this institution so important to the rise of the English state?

The answer is that the basic conflict in the Court of the Exchequer was between the treasurer and a sheriff. In medieval England, a "sheriff" was really a governor, the governor of one of the provinces of England. So the conflict was between two parts of the government. The treasurer was the representative of the central government; the sheriff was the governor of a province. The King of England had a treasurer to keep his money, but he really only controlled England through his various sheriffs, who governed his provinces.

The word sheriff in Latin is *comes*, which also means count, and in many parts of Europe then, the counts, the local governors, were essentially becoming independent local rulers as national governments were breaking up. To rule England, the King had to be able to control his governors. But as powerful governors, the sheriffs in 1180 had great opportunities in their provinces to abuse their power and exploit the local farmers. To deter such malfeasance, the king needed to assure his sheriffs that loyal service, doing a good job of managing their county or province, would earn the sheriffs great rewards in the long run, but that they could forfeit these long-run rewards if they were found to have abused their power.

In economic theory today, such promises of long-run rewards to motivate good behavior are called "moral hazard rents". In any organization, when responsible officials have great power that can be abused in the short run, those officials must be motivated by the promise of large moral-hazard rents (Becker Stigler, 1974). But these promises become a debt for the organization, a debt which the organization's top leaders could try to nullify by accusing the official of malfeasance. In this case, the organization was the English monarchy—the monarchy of King Henry II of England. So King Henry II of England could have been regularly tempted to find some of the sheriffs falsely guilty of malfeasance, so that he could escape the burden of rewarding the sheriff. But the sheriffs would only govern England appropriately on his behalf if they trusted that the king would judge and reward their performance appropriately. So how could an absolute monarch solve this problem and commit himself to judging his sheriffs appropriately? This Court of the Exchequer enabled the king of England to solve this problem. Each sheriff met the treasurer twice a year at the Court of the Exchequer, to settle the sheriff's accounts, and a large subset of the most powerful people in England gathered also at the Court of the Exchequer just to observe the transactions and verify everything that took place. This Court was carefully designed so that, if the king needed to dismiss a sheriff for malfeasance, everybody would know that it was for good cause because everything that the sheriff had been doing was

publicly recorded at the Exchequer.

Elsewhere strong monarchies have developed similar institutions, courts where the monarch could guarantee to his high officials that they were being appropriately judged and allocated rewards or punishments. The Imperial Court in traditional China had one of the best developed systems of record-keeping to provide a clear basis for decisions about promoting or demoting government officials throughout the empire. But Chinese history also has one of the most striking examples of failure of such a system of political judgments, in the unjustified execution of the great general Yuan Chonghuan at the end of the Ming Dynasty. After Chonghuan's execution, the last Ming Emperor lost the trust of his generals and governors since they didn't know whether they were going to be rewarded or punished arbitrarily (Mote, 1999). The downfall of the otherwise powerful Ming empire was caused largely by the simple failure of basic trust by the Emperor's generals and governors. Such mistakes are rarely made. Wise kings do not do what the last Ming emperor did to Yuan Chonghuan.

The English common law

The second great institutional development I will cite evolved during the reign of England's King Henry II: the English common law. When Western economists think about the institutional prerequisites for modern economic growth, the development of a system of law is generally at the top of our list. Economists understand that economic growth requires investment, which will be discouraged unless investors get credible protection for their investments. Investors need protection. In the West, businessmen have come to expect that their investments will be protected by a system of law and legal institutions that date back to ancient Roman times. Based on such ancient roots, the great common law tradition in England really began to develop under Henry II also around 1170, leading directly to the legal tradition that we have in America and Britain today.

Among Chinese philosophical traditions, there is tradition that sounds similar to common law: legalism or *Fa Jia* (法家), but *Fa Jia* was not a form of commercial law, it was a theory of how the king could set up laws for exploiting his citizens, not for protecting their private investments. However, it is clear that over much of the past 2,000 years Chinese businesses have invested and grown even without institutions that were formally equivalent to Western law. The great success of Chinese industry and technology tells us that traditional China had successful

institutions for protecting citizen's investments. Something in traditional Chinese society was successfully playing the same role as Western law.

When I have studied Chinese history to identify an institutional development that seems to most closely parallel the development of the English common law under Henry II, I have recognized the great development of the Confucian civil-service examination system under the early Song emperors. The Chinese Confucian civil-service examination system also had ancient roots, going back to Han times, but it really became a central institution of imperial government in the Song Dynasty, beginning around 970 AD. Although the common law and the civil servant examinations might seem to be rather different things, their origins show a significant similarity.

To see the similarity, we should first ask why did Henry II, an absolute monarch, establish a system of judges and give them so much independent judicial power? Henry and his mother had fought a long civil war against his uncle Stephen, but there was final agreement to transfer power peacefully from Stephen to Henry after Stephen's death. Thereafter, to keep the peace, Henry had to make sure that his mother's supporters and Stephen's supporters could live comfortably together under the new regime. In England in those days, land was the key to power, so Henry needed to set up a system to adjudicate disputes about land in a way such that sometimes his supporters would win the land disputes, and sometimes Stephen's supporters would win the land disputes. This way, Henry himself would not be responsible for disappointing either side.

So Henry developed a court system that combined elements of centralization with a decentralized dependence on local governments. The king centrally supervised the appointment of judges, but the judges in court put questions to independent juries that consisted of members of the local gentry, and the provincial sheriffs enforced the judicial orders.

Now compare this to the development of the Chinese civil servant examination at the beginning of the Song Dynasty. After the downfall of the Tang Dynasty, the subsequent Five Dynasties and Ten Kingdoms were reunited under the Song dynasty. There was a remarkable degree of peaceful acquiescence from the Ten Kingdoms, as most of them were willing to come together under Song rule. This could happen only because the Song Emperors provided an institution, the civil-service examination system, that could guarantee that power and high offices would be shared fairly among their supporters and the supporters of the courts in the various Ten kingdoms. People from all the former Ten Kingdoms had equal opportunities to take the civil-

service examinations, and so they could feel that they would have an equal chance of getting official jobs in Song China. (See Bol, 1998, page 188.)

So the historical origins of the Chinese civil servant examinations system and of the English common law look politically very similar. Both were originally designed to assure members of rival political elites that their ability to enjoy certain privileges would be protected under a new national leader. Within a few decades, however, the protection of rights under these systems was extended much more broadly to people of other social classes throughout the population.

The similarity in origin of the English common law and the Confucian civil service examinations suggests that perhaps they might also have a similar function in society. The Confucian system was first and foremost a system of law for interactions among government officials. Confucian scholars learned a complex system of principles that defined how worthy people should treat each other, and these principles of Confucian behavior were effectively a form of law for the Confucian scholar-officials. In this traditional imperial system, other people who needed to protect their investments could either get a family member into the Confucian elite, or else they could give a share of their profits to a government official.

However, in the Song period, the number of people in the Confucian elite quickly grew larger as more people passed the basic Confucian examinations than could actually get government jobs. These certified Confucian scholars who could not get government jobs became local gentry; they enjoyed a privileged status since the Confucian system defined how worthy people should be treated. The certified scholars became leaders in the communities where they lived, taking some of the responsibility for local governance. Thus, in Song China, the Confucian education defined a system of rules for how government officials should treat one another, and then other people outside the government could get protection either by sharing this education or by forming personal relationships with scholar-officials.

In the West there has been more of a barrier between governmental officials and those outside of the government. But the West has instead provided professional lawyers to speak in the king's courts on behalf of people who were outside the governing elite.

Parliament

A century after Henry II, around 1300, his great-grandson King Edward I presided over

the next great institutional development in medieval England: the development of the Parliament. Edward was an autocratic monarch, and he certainly did not develop Parliament just to give power to the masses. He saw it as a way of strengthening the state. Indeed, it was after the introduction of Parliament that England was able to launch the Hundred-Years War against France, even though France was a larger country. To understand how Parliament strengthened the English monarchy, it is important to understand who was represented in the parliament in 1300, the first century of Parliament.

The people who were represented in the first English Parliament were the rural gentry and the urban oligarchs. That is, the early Parliament gave representation to the local officials who exercised the power of the state at its lowest level (Coss, 2005). Remember that the English kings could credibly promise to appropriately reward and punish the service of their provincial governors (or sheriffs) by providing them a strong court, the Court of Exchequer, in which their grievances could be heard. There were only a few dozen governors, but the local gentry who were responsible for collecting taxes and adjudicating disputes in towns and villages were a much larger group, too large to assemble regularly in one national court, and they could send representatives to meetings. Thus, for the king to extend credible promises of appropriate rewards for the service of these local gentry, he needed to create a forum for their representatives to complain about any abuses of their privileges by higher government officials. This forum was the Parliament. Before the king could raise new taxes, he had to first hear complaints from his local administrators and local tax collectors about abuses of power at higher levels of government. Thus, parliamentary representation strengthened the state by creating decentralized protection for the moral hazard rents of thousands of local government officials.

When I look for an analogue to Parliament in traditional China, the closest institution that I can find is the Confucian system of circulating memorials by scholar-officials. Officials at even low levels of the state bureaucracy had the right to submit written memorials to the Imperial Court that were widely circulated (R. Huang, 1981). This institutionalized mechanism for publicizing complaints could help to assure local officials everywhere that their service would be judged and rewarded as appropriately as possible by the high imperial officials, because the high officials would know that an unjust treatment of any one local official could lead to a complaint that might provoke or demoralize other local officials throughout the empire. But while the Confucian memorial system gave a national political voice to government officials, who

generally served outside their home region, the parliamentary system in Europe gave national representation to the larger groups of gentry who formed local governments in the towns and villages where they lived.

The fact that towns were represented in Parliament made them particularly effective as engines of economic growth in the early modern era. To see the importance of this effect, it may be useful to compare the political institutions of England, Spain, and Poland. Around 1600, all of these countries had representative national parliaments (called the Cortes in Spain, the Sejm in Poland), and in some ways the parliament of Poland looked the most developed by modern standards. But only the rural nobility had representation in the Polish parliament; Polish towns had no voting representatives. The Spanish parliament included representatives from their major towns, but these towns also controlled much of the rural land around them. Only in England (and the Netherlands) do we find towns that are represented in the national parliament but do not control the agricultural land around them. For the local leaders of a town that does not control a larger region, the only taxable source of wealth is the town's reputation as a good place for people to do business. When they have power in the national political system, such towns naturally favor policies that assure good protection of property rights for all their residents, and they will support peasants' rights of mobility to come work in the towns.

On the other hand, the fact that rural gentry were also represented in England's Parliament was also important in the 1700s for the creation of turnpike trusts, which were local companies that built toll roads throughout England, giving England the best transportation system of the 18th century, and thus setting the stage for the industrial revolution. These toll roads were owned by the local gentry, but they also had to be nationally regulated as part of the national transportation network. The local gentry's confidence that their investments would not be subsequently expropriated by central-government regulation depended heavily on the fact that they were politically represented in England's Parliament.

I have not found anything in Chinese imperial government that would correspond to the institutionalized ability of autonomous local governments to have influential voices in national politics that we find in England's Parliament. But after the fall of the Ming Dynasty, Huang Zongxi argued for the need to decentralize more autonomous local authority to local Confucian academies. And at the end of the subsequent Qing Dynasty, the Imperial government's decision in 1911 to nationalize railroad companies that had been sponsored by provincial governors led

directly to the downfall of the Qing dynasty (Feuerwerker, 1958).

Federal democracy

When England established colonies in America, each colony had its own provincial assembly of representatives from each town or county, like the Parliament of England. In the American Revolution, the provincial assemblies of these 13 colonies proclaimed themselves States and united together with a national Congress, to form the government of the United States. Then, as the right to vote to elect representatives was extended to broader classes of the population, more people could feel confident investing in England and America, which established the political foundation for the great economic growth of both countries in the 19th century. As a result, Americans have come to believe deeply in democracy.

The theoretical argument for the value of democratic competition in politics is very similar to the economic argument for free competition in markets. Privileges of power can motivate political efforts, just as profits motivate economic production. But as market competition can limit profits and yield better values for consumers, so democratic competition should limit elite privileges and yield better government for the public. This is the basic argument for democracy. Even a benevolent emperor would find it difficult to resist his courtiers' urge for greater privileges if further exploitation of the public would entail no risk of losing power.

But sometimes this simple theory of democracy sometimes does not seem to work, and competitive elections may fail to yield better government. Even with free elections, a corrupt leader can maintain a grip on power if the voters believe that other candidates would not be any better. If anybody who wins would use power only to help his personal friends, then people may rationally vote only for a candidate with whom they have some personal connection. Indeed, the world has seen unsuccessful efforts by America to build democracy in other countries, like Iraq and Afghanistan, with disappointing results (Myerson, 2009, 2011).

We must recognize that a successful democracy requires more than just elections; it also requires alternative candidates who have good democratic reputations for using power responsibly to benefit the public at large, not merely to reward a small circle of supporters. Long-term economic development in any community depends on essential public goods like roads and schools, and a majority of voters should prefer leaders who will spend public funds to

provide such public goods efficiently. But if nobody has a reputation for spending public funds responsibly for public goods, then democratic competition can fail to yield any benefits for the public.

Thus, the key to successful democratic development is to increase the supply of leaders with good reputations for spending public funds responsibly. Local governments provide the most opportunities for leaders to begin cultivating such reputations, and so the chances for successful democratic development are greatest when democracy begins with local elections. Indeed, although American efforts to build democracy in Afghanistan were focused on national presidential elections, democratic development in America actually began with decentralized local democracy. Democracy in America has always been federal, in the sense of having separately elected offices at the local, provincial, and national levels.

The key point is that a record of using public resources responsibly in local government can qualify a local leader to become a competitive candidate for power at higher levels of government. In effect, local democracy can reduce barriers against entry into democratic competition at higher levels of government, and thus local democracy can make elections at higher levels more competitive. Furthermore, local officials have more incentive to provide better local public service when they anticipate that such good public service at the lowest level of government could make them stronger candidates for winning the trust of voters at the next higher level of government. So elections at higher levels of government can also help to sharpen the competitive incentives for good government in local democracy.

Also, the threat of a small unrepresentative clique dominating a local government can be reduced by democratic competition among different factions at higher levels of government, when officials at higher levels of government have the ability to certify and support candidates in local elections. Unpopular local political bosses should know that, even if they have some friends in higher levels of government, they could face serious challengers supported by a rival faction if they do not provide good public services for the majority of local voters. Thus, successful democratic development may depend on an interaction between democracy at different levels of government, from local to national.

In fact, the success of democracy in America has always depended on this incentive to achieve democratic advancement through a ladder of elected offices from local to national. From the very beginning of the United States, we find leaders who were first elected to local

office, then were elected to state (provincial) office, and finally became candidates for national leadership. So this long tradition of democratic local governance has endowed the United States, from its beginning, with large competitive supply of leaders with good reputations for spending public funds responsibly. In this regard, we should recognize important differences between the centralized presidential democracy that America has been trying to cultivate in Afghanistan and the decentralized political system from which democracy actually developed in America itself.

I have told this story of the development of modern political institutions with a focus on the history of England and America, because that is the history that I know best. But the great achievements of development here in China and throughout the world have similarly depended on local and national political institutions that together can assure people everywhere of a good secure environment in which they can make investments for a better life.

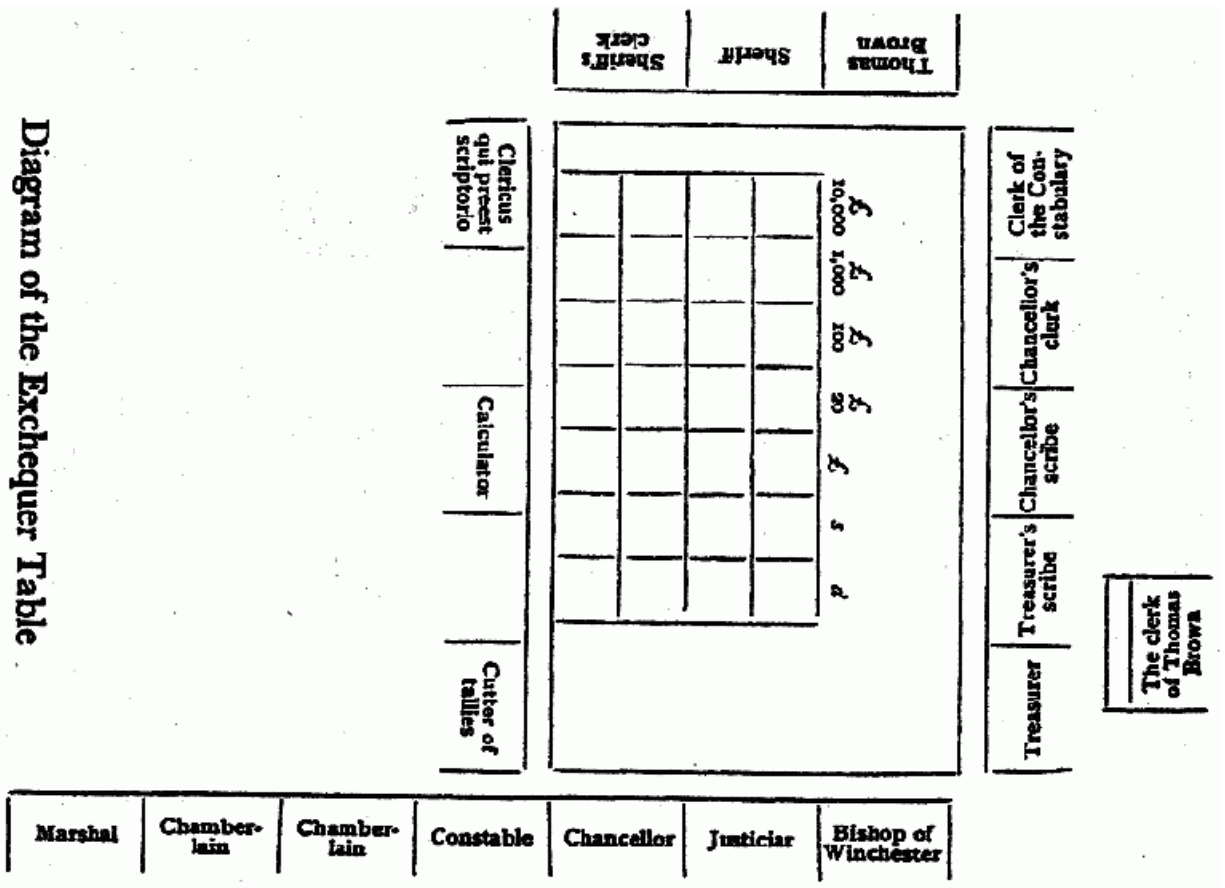
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Diagram of the Exchequer Table



"Why is the Exchequer so called? ...Because the table resembles a checker board... Moreover, just as a battle between two sides takes place on a checker board, so here too a struggle takes place, and battle is joined chiefly between two persons, namely the Treasurer and the Sheriff who sits to render account, while the other officials sit by to watch and judge the proceedings." Richard FitzNigel, Dialogue of the Exchequer (c. 1180), translated by Charles Johnson (Oxford, 1983).