*This paper is still in process. Comments welcome.

Principled Principals in the Founding Moments of the Rule of Law

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Institutionally, the rule of law consists of the laws that protect personal security and private property and the means for monitoring and enforcing obedience with those laws. Rule of law institutions are only effective to the extent that the powerful of the society believe they, too, are subject to the law and the populace believes in the value of being law-abiding. If office holders and the privileged act as if they are above the law, the rule of law becomes fragile or non-existent. When coercion is the only or even primary means to achieve compliance, laws may exist but not the rule of law. The rule of law requires legitimacy, at least if legitimacy means reasoned deference to authority (Tyler 2006). This applies equally to corporate elites who manage the economy, state agents who make and implement the laws, and the citizens asked to obey.

Achieving legitimacy and with it a relatively high degree of voluntary compliance with the law is neither simple to achieve in the first place nor easy to sustain over time. Without shared consensus on what the basic outlines of the law should be, competing conceptions of law undermine the rule of law even in what appear to be stable societies.

As groups previously excluded from or even harmed by the laws gain power, they may unsettle the status quo, particularly if the legal changes required mean major restructuring of valued privileges. Whether such rifts tear a society apart depends partially on whether the laws can easily be reformed to become universally fair and non-discriminatory and if a generalized belief exists that the rule of law is worth having and preserving. Both of these beliefs often have their source in the founding moments of a society, during the process of constitution-making, institutional design, and articulation of national principals through laws and nation-building rituals. Crucial to this process, we argue, is principled leadership that credibly signals its type and commitments.

Suffice to say, important structural and institutional factors must inform a complete analysis. Our emphasis here, however, is on those founding moments when the requisite factors exist that make possible the design and maintenance of the rule of law. Well-designed institutions are necessary but not sufficient. The rule of law also requires leaders who can credibly commit to self-constraint, agents who can be trusted to abide by the law as well as enforce it, and reasons for most of the population, both the powerful elites and the general mass, to believe they will benefit from the existence of the rule of law.

Once established, the rule of law can become a self-enforcing equilibrium in which social actors are able and willing to defend against transgressions of their rights by the state (Weingast 1997). This is a Madisonian model in which it is necessary to build in protections against the knaves but in which most people prefer to maintain the rule of law if possible. No one, save for some few outliers, desire to deviate from the equilibrium. A situation in which the state is rife with corruption, favoritism, and other

activities anathema to the rule of law will be one in which few have any incentive to act in a manner supportive of its development. This is law-breaking equilibrium is one in which cooperation and compliance produce sucker payments. Both equilibria are stable, and the critical issue is how to transform a law breaking into a rule of law equilibrium.

The existence of a rule of law equilibrium is self-enforcing in part because it can create a virtuous circle of increasing levels of voluntary compliance (Levi and Sacks 2007). The expectation of its durability over time contributes to the production of Tocqueville's "self-interest rightly understood (Tocqueville 1990 [1840]);" individuals believe that it is worth the costs of their compliance to obtain long-term benefits. In the absence of a rule of law equilibrium, few incentives exist for state agents or subjects to follow the rules. Individuals know they will end up being suckered, and they lack confidence in downstream individual benefits to their compliance.

The conception of law as equilibrium captures a significant but static reality. It fails to sufficiently credit the efforts put into the reproduction and maintenance of the rule of law. Yes, once established, an effective rule of law should produce the incentives for relevant actors to continue to uphold it. Yet, as definitions of rights change, and as new actors become part of the polity, reproduction becomes both more problematic and more important.

We know something about what maintains the rule of law once it is in place, albeit not enough. We know far less about how to create it initially. Yet, in countries throughout the world that is the pressing question. We are increasingly learning that citizens will give their voluntary compliance to government if government is stable, relatively effective in providing social welfare, and relatively fair and procedurally just

(Levi, Sacks, and Tyler forthcoming; Levi 1997; Tyler 1990). What we know considerably less about is how to produce such governments in the first place (Levi 2006). Social scientists and policy-makers are fairly confident that the rule of law is essential to effective state building but are considerably less certain about how to bring it about.[1]

We model this process in four stages (see figure 1). At time 1 nature moves by providing a leader (or leadership cadre) who has won a war, led a revolution, or otherwise successfully established a basis for governing the society and, potentially, creating or reforming its institutions. If this leader possesses a principled commitment to developing the rule of law and to making herself subject to it, then the rule of law stands some chance of developing. Unprincipled leaders or leaders with the wrong kinds of principles (i.e., those with ideologies that discount the importance of the rule of law) abound; those with the right principles are far scarcer. However, for discussion of the rule of law, principled leaders of the right sort are the ones that matter. We know from history that such people exist and can be used as models for other leaders trying to decide the path to take.[2]

At time 2, the principled leader faces powerful others who choose to cooperate

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[1] "Order in the Jungle", *The Economist,*

http://www.economist.com/displaystory.cfm?story_id=10849115 Accessed 11 May 2008.

[2] We shall not spend time in this paper examining the ways in which such leaders might be encouraged or even trained, but we recognize this is an essential component of a fuller argument.

with the leader's efforts to establish the rule of law—or not. If not, the game is over

(although, in fact, the leader and constituents may continue to interact in an effort to

realize cooperation). The defining moment, however, is when the leadership achieves

sufficient cooperation to engage in institutional design for the future. At time 3, the

leader, with the cooperation of powerful allies, chooses an institutional design. If the

design involves *credible constraints on both the leader and on others with power*, the

rule of law becomes possible. The combination of the institutional design, principled

leadership, and appropriately functioning bureaucracy should, at time 4, produce

legitimating beliefs and, therefore, compliance among the population served by the state.

A rule of law equilibrium results. If the design is poor or poorly implemented, the rule of

law is unlikely or, at best, exceedingly fragile. No equilibrium obtains unless the

institutions are redesigned to constrain powerful societal actors and government officials.

Many analyses of the emergence of the rule of law start from the point at which

society is already in one or another equilibrium state. The key actors have coordinated or

failed to. This analysis starts with the foundational moments for institutional design. It

begins to theorize rather than simply assume the leadership type and the interaction of

leaders with powerful others. It emphasizes the importance of constraining all those who

could undermine the rule of law, including societal actors, government leadership, and

the officials who staff government. It makes it clear where external agencies can

intervene and make a difference. They can do more than help write the constitution.

Their influence will also be constructive at time 2 when those in society are deciding

whether to cooperate with leadership; here is where external agents can provide resources

that will affect the incentives of those considering defection. Only then can institutions

emerge that are worth far more than the paper they are written on.

FOUNDING MOMENTS

The founding moments of states, indeed of any organization, are critical to the beliefs and culture that will develop over time. Culture here refers not to the ethnographic, religious, racial, or ideological features of a society—although they can play a role. It refers to the defining norms and consensual values that influence the way members of the organization interact with each other. It refers to both the horizontal relationships among citizens and the vertical relationships with those who govern. It is culture in the sense David Kreps used the term in his seminal discussion of "corporate culture" (Kreps 1990): a set of principles that constitute the identity of the organization and establish the rules to guide the behavior of its members. In his model, and in ours, leadership is key.

This is not the moment to rehearse the debate about the relative influence of religion, geography, natural endowments, what the colonizing power did and when, or other structural features of a society that can influence the nature of its laws and the inclination of its people to support them.[3] While important, these large structural factors are the backdrop to the founding moments of institutions and constitutions.

Founding moments self-evidently occur at the birth of the state or other

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[3] The literature is long and getting longer. Important contributions include Acemoglu, Johnson and Robinson 2001; Lipset 1959; Przeworski 2004; Acemoglu, Johnson and Robinson 2002; Engerman, Sokoloff and Haber 1997; Sokoloff and Engerman 2006. North, Wallis and Weingast forthcoming are soon to publish a relevant book, and both James Mahoney and Steven Wilkinson have manuscripts in process.

organization. However, organizations can and do rebuild themselves and thus experience renewed founding moments. Firms often do this. So do voluntary organizations.[4] Much can be learned from the behavior of such organizations, and much of what follows draws on arguments and findings concerning these founding or, more accurately, refounding moments, particularly in those instances when leaders design institutions that constrain themselves as well as constituents and officials.[5]

Among states, few examples exist of a national government and organizational culture arising totally de novo: the United States is an exception, not the rule. And even it had a redefining moment as a consequence of the Civil War, as well as numerous redefining moments as women and African-Americans gained the suffrage and as the conception of protected civil rights changed. Older states went through major transformations: France as a result of its Revolution; Britain in the aftermath of centuries of traumatic wars, internal and external; Germany and Japan following World War II. India's founding moments came with its independence from Britain and the legacy of institutions and values from which the Indian constitution-makers could pick and choose while adding something of their own. South Africa very clearly had to revise and then

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[4] Notable examples include the transformation of the dockworkers' union on the West Coast of the US after its Big Strike of 1934 (Levi 2005) or the reinvention of itself by the Young Men's Christian Association when its traditional base was replaced by a very different demographic group (Zald 1970).

[5] This is research on the reasons for variation in the organizational cultures of unions, supported by grants from the National Science Foundation SES-0717454 and SES-0517735 and from the Harry Bridges Center for Labor Studies, University of Washington.

recommit to what it meant by the rule of law in the process of abolishing Apartheid. At this very moment, Nepal is struggling with what it will become with the abolition of the monarchy and the election of the former Maoists to power while Pakistan tries yet one more time to establish a constitutional basis for governance and the rule of law. Throughout the world countries are experiencing moments that could, in retrospect, be foundational.

They are also struggling to incorporate multiple bases for law and authority. Malaysia, Singapore and many Islamic countries are searching for ways to combine what they value from the colonial legacy with *sharia* and other forms of both codified and customary practice (Hussin 2007). Countries throughout Africa, both sub-Saharan and northern, are still in conflict over the standing of traditional practices, such as female circumcision. The battle over headscarves is a battle over what the rule of law means in countries with histories as different as Turkey and France. Sweden, Denmark, and the Netherlands must incorporate new laws along with new immigrants.

These conflicts vary in their likelihood of tearing governments apart. At least part of the explanation for variable effects has to do with how the governing constitution emerged as much as with what it contains. Certain features of these foundational moments appear to be crucial to the emergence and survival of the rule of law. Their presence does not ensure a stable equilibrium. Their absence appears to ensure a return to chaos.

The first such feature is principled leadership. Without the right kind of leadership, neither state agents nor the members of the polity will come to believe that they are in a situation where corruption is unacceptable and laws likely to be upheld.

Principled leadership with the right motivations and incentives to make their

commitments credible is essential for the establishment of the institutional arrangements

that provide both rules and rights. The quality of leadership also matters when existing

rule of law arrangements are under stress due to major shifts in power relationships. They

may be key to whether repression or freedom is the outcome.

The second requirement, largely dependent on the first, is the existence of a

bureaucracy that is itself law-abiding, that implements the laws of the state in a way that

is both relatively honest and procedurally just. This is where the organizational culture

established by the founding leadership plays a significant role. Once the appropriate

organizational culture is in place, the rule of law becomes possible. It is still, however,

fragile. When the first mover dies, is replaced, or experiences a motivational change, the

rule of law may fall apart. To establish the rule of law as a stable equilibrium requires

the establishment of an incentive structure that encourages enough of the state agents to

uphold the law and, in addition, to report and punish those who break it. Only then will

citizens have good reasons to believe that they are in a state of the world where the rule

of law exists, and only then will they calculate that it makes sense to comply and ensure

that others do.

The third requirement is the existence of citizen beliefs that they should be subject

to the law and do their best to uphold it. Levi models popular compliance with

government demands as a problem of quasi-voluntary compliance (Levi 1988, 1997).

Compliance with and obedience to the law is contingent upon citizen (or subject)

perceptions that government is meetings its obligations to them, has the capacity to locate

and punish free riders, and is acting according to prevalent standards of fairness and

procedural justice. To the extent citizens (or subjects) believe their government is trustworthy, fair, and capable of delivering on its promises, the more voluntary compliance it is likely to elicit. Coercion is always a requirement and a backdrop to quasi-voluntary compliance, providing assurances that law-breakers will be compelled to obey or be punished. But an effective rule of law relies on consent as much or more than coercion.

Quasi-voluntary compliance is essential for maintaining the rule of law, but it is not the first step in the process of building an effective rule of law regime. The basis for quasi-voluntary compliance has to be constructed. The emergence of the rule of law requires the right set of institutions, yes, but it also entails beliefs—among leaders, bureaucrats, and citizens—that the rule of law exists, will continue to exist, and is of sufficient benefit to deserve their compliance, consent, and active support.

PRINCIPLED LEADERSHIP

Charismatic leaders, traditional authorities, and strongmen abound, but how often does a Nelson Mandela appear or a cadre of political elites similar to the Founding Fathers of the US or the constitution makers of independent India? Motivations that encapsulate the interests of the general public,[6] the possibility of long-term survival, and the capacity for intelligent law making are rare in combination. Does this reduce the probability of locating principled leadership to near zero? The goal is not to locate a new Solon. It is to create an environment in which rulers—whatever the initial source of their authority—

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[6] This draw's on Hardin's conception of "encapsulated self-interest" (Hardin 2002).

find it in their interest to establish a reputation as a principled leader who stays true to those principles even in unforeseen circumstance that require actions in violation of their short-term interests.

Ideology and morality are the drivers for some leaders. Not all ideologies encompass commitments to the rule of law, of course. Marxist and nationalist credos motivate revolutions but may also include rationales for opposition to private property rights or equal protection under the law. What matters are those ideologies that include a commitment to a process for creating institutions that will ensure protection of persons, property and rights over time. Moreover, the core principles must be shared beyond the great men and women who are the heroes and martyrs of the story and the foundational leadership cadre. The rule of law requires normative acquiescence as well by those with the political power and influence to undermine the institutional arrangements of the state. Assent is more likely when the principled leadership offers a model of action and not just of ideas.

A demonstrated willingness to suffer for one's principles enables a leader to offer a costly signal of intentions to establish and then be bound by the rule of law. George Washington fought a war. Gandhi lived in poverty. Nehru and Mandela went to prison. Suu Kyi lives under house arrest. Others have suffered exile or torture for their cause. Equally importantly, when the founding moment came, they discernibly worked hard to translate their ideals into constitutions, laws, and governance practice. Most subjected themselves to elections and term limits or left office willingly. Their principled action embodied and conveyed the norms they hoped would underpin the governance structures they helped create.

Principled leadership does not necessarily have to be democratic, however. What defines its commitment to the rule of law is the willingness to be bound by the laws and to ensure that the laws are implemented and enforced universally. Singapore offers a contemporary case in point. Its leadership is autocratic, and its violations of democratic rights and processes mean that it falls outside some broad definitions of the rule of law. Nonetheless, it is a country famously governed by rules that are obeyed. Its prosperity and stability are among the consequences.

Nor do all the founders who begin as principled leaders survive with their principles intact. Power does, after all, corrupt. A recent example of such a phenomenon is the presidency of Mikheil Saakashvili in Georgia. Coming into office in 2003 on a wave of popular support during the Rose Revolution, he instituted a number of reforms, including cracking down on corruption in many branches of the civil service, earning Georgia accolades by the World Bank (2006). However, when substantial political opposition appeared and protests similar to those led by Saakashvili in 2003 occurred, the principles evaporated, and Saakashvili declared a state of emergency, cracking down on protestors and curtailing media independence. A more extreme example is Robert Mugabe in Zimbabwe, vaunted as a principled leader during the 1980s and by the end of another decade considered one of Africa's worst authoritarians (Kohli 1987, 233-35).

Principled leadership is often grounded in moral and ideological motivation, but it can also have sources in more instrumental stimuli. Membership in a group creates dependencies that lead individuals to conform to the group norm, even coming to believe it over time (Hechter 1987). It also creates networks of obligation and reciprocity in which reputation is key for achievement of further goals (Cook, Hardin, and Levi 2005),

Membership has this effect as much for a privileged elite as for the participants in a commune. The process of winning independence or toppling a previous regime further forges and enforces a common worldview. The founding moment for establishing the rule of law then institutionalizes that worldview and its concurrent norms.

A leader can abide by principles and use them as a basis for rule even if that leader is instrumental. That's what Machiavelli advocated in *The Discourses* (Machiavelli 1950) and what Machiavellian has come to mean. Augustus Caesar offers a classical case in point. Hardly a saint and most certainly personally ambitious, the desire to create a dynasty, maintain peace, and nurture economic growth that would make himself, his followers and his people better off and more loyal led him to encourage the establishment of laws that would govern his officials as well as the people. The aim was to ensure the predictability required for investment and trade.

Augustus initially stayed true to the principles he laid out, but before too long he strayed. Without effective constraints that operate over time, it is not surprising that an Augustus would deviate. Even the principles of the most principled of first movers are susceptible to corrosion, as the previous examples of Saakashvili and Mugabe demonstrate. Competition, dependency, and countervailing power are what constrain a leader. They are in part a consequence of institutional arrangements that enhance or delimit ruler power, but they are also determined by the resources available to the ruler and to those with whom she must bargain (Levi 1988). In the founding moments, when institutions, even if they exist, are fragile, who has and who uses their bargaining power can make the difference as to whether the rule of law is even a viable option.

THE BUREAUCRACY AND RULE OF LAW REFORMS

Regardless of the level of commitment by principled leaders to establish the rule of law, they will have to make it worthwhile for other powerful actors in the society to cooperate. Political and economic elites—through action or inaction—can spur, hamper, or torpedo moves towards the rule of law (Weingast 1997; Sachs and Pistor 1997). So, too, can the judiciary (Widner 2001; Helmke 2005; Moustafa 2007; Guarnieri 2003). Our emphasis here, however, is on those who staff the state (Levi 2008) and whose task it is to implement the law. The influence of the bureaucracy has been inadequately explored, but its impact on reforms can be determinative.

Bureaucrats and officials throughout state administrative agencies can engage in corruption, shirk their mandates, and selectively enforce laws. They have the capability to openly sabotage attempts by a leader or leadership cadre in moving to a rule of law equilibrium. The strategic interaction between leaders and staff has consequences for the preferences of the state leadership with regard to pursuing rule of law reforms. Greif (2007) explores this aspect of what he labels administrative power, conceived as "the extent to which the ruler's choices and outcomes are influenced by potential defiance by those with administrative capacity."[7] A leader facing agents with high levels of administrative power may decide reform is hopeless and make no attempt to pursue it. A

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[7] Greif suggests a number of potential equilibria that develop given the combination of the costs of replacement and of technological, environmental, and cultural factors. He offers the beginnings of a useful model that fits well with our purposes here.

leader, no matter how principled, who lacks the courage or capacity to transform the

bureaucracy, may instead be bowed by it.

Presuming, however, that leadership has pushed ahead, the founding moment

provides an opportunity to reestablish the administrative practices of the state. The

choice of institutional design and the content of the organizational culture not only ensure

the emergence of the rule of law but also facilitate its survival over the *longue durée*.

The moment of founding provides a strategic opportunity for leadership. Having solved

certain problems of establishing a state and the peace that makes state building possible, a

ruler has the confidence—however briefly—of the population and can undertake

institutional design (or redesign). How she uses this window in which her charisma and

potential are high can make all the difference for the possibility of an enduring rule of

law.

Principal-agent problems

Principal-agent problems are at the heart of the difficulties principled leaders face in

establishing the rule of law. Agency theory clarifies how asymmetric information and

divergence of interests between the agent and the principal can affect bureaucratic

behavior. If leaders are unable to solve their agency problems and motivate government

staff to implement the law and to do so fairly, then the rule of law is non-existent.

Bureaucratic recalcitrance through underperformance can make it impossible to establish

a rule of law equilibrium or upset it once established. Whether it is simply by shirking

job duties and failing to implement policies, or by the selective enforcement of laws,

underperformance has detrimental effects on the diffusion of the new organizational

culture the founders are attempting to create. Moreover, bureaucratic failure to implement laws fairly undermines citizen beliefs that the rule of law actually exists.

At time 2 in Figure 1, principled leaders strive to obtain the cooperation of other powerful actors in society. Our emphasis is on those who staff the state. Obtaining the explicit cooperation of the myriad officials and bureaucrats who compose the staff is highly unlikely but, thankfully, unnecessary. If leaders are able to constrain the discretion of staff and prevent them from obstructing reforms, the bureaucrats are effectively "cooperating" with such reforms and unable to meaningfully challenge the establishment of the rule of law.

Mechanisms for constraining government officials and bureaucrats are of two general types: vertical accountability; and horizontal control. Elections are the archetypical form of vertical accountability in democratic politics. Retrospective voting provides citizens with the opportunity to "toss the bums out" when state officials are viewed as under-performing or abusing the positions to which they were elected (O'Donnell 2004). Electoral mechanisms function effectively for officials whose positions are contingent on the party or legislators in office, but it has little impact when there is a civil service or other system that insulates bureaucratic jobs from electoral changes. Another form of vertical accountability, similar to what some have called "societal accountability" (Smulovitz 2003), depends on interest group lobbying, grassroots campaigns, and watchdog groups as the monitors. This may be more effective than elections in controlling bureaucratic behavior.

To produce societal accountability principled leadership must foster an environment in which public associations, the media, and non-governmental

organizations are able to function freely, with a minimal number of regulations allowing for bureaucrats (at any level) to interfere with their activities. Contemporary Russia offers an exemplary negative case, where recent changes in the statutes governing non-governmental organizations have created a situation of ambiguous rules and wide latitude in enforcement, and the state control of media has hobbled the ability of society to monitor the agents of the state (Blitt 2007; Fish 2005). The unprincipled leadership of Russia produces policies aimed at dismantling, rather than building, those institutions that might, in the right circumstances, help sustain a rule of law equilibrium.

Principled leaders possess a larger number of available mechanisms for constructing effective means of horizontal control, that is, the use of state institutions to monitor and sanction other arms of the state and hold other state actors accountable. Competing arms of the state bureaucracy, oversight agencies, and offices designed to elicit citizen reports of abuses are all mechanisms of horizontal accountability, in which some institutional feature of the state is used to check another.

Many of the findings agency theory are more applicable to firms than to states. Moreover, the literature generally assumes features of advanced industrial economies—such as effective communications, transportation, and record-keeping—that ease information transfer and effective monitoring and sanctioning, assumptions that do not necessarily hold in analyses of less-developed countries (Kiser and Sacks 2008; Kiser 1994). The implication is that the mechanisms of horizontal control available in advanced industrial economies may not necessarily exist elsewhere. The wholesale transfer of institutions of accountability from the developed to the developing world will not work without also transferring the infrastructure that supports the institutions.

Efforts at judicial reform in post-Soviet Estonia and Latvia are illustrative. The two countries inherited identical institutions and highly similar economies at the collapse of communism, and both sought to bring their judicial systems into line with European Union standards. A decade after the collapse of communism, the Estonian judicial system worked relatively well but Latvia's was corrupt and performing poorly. Estonia's leadership devoted resources to modernize its judicial infrastructure and to enhance effective communication and information-sharing across the population. Latvia's courts were still operating largely with Soviet-era technologies and practices (Open Society Institute 2002).

Winning the cooperation of bureaucrats in time 2 partially depends on, among other factors, the design of institutional arrangements that elicit staff effort, reduce shirking and corruption, and at the same time signal the leader's type as principled. Ensuring the maintenance of that cooperation as well as achieving citizen compliance requires, at time 3, the further institutionalization of arrangements that facilitate the rule of law. If institutions are designed properly, future bureaucratic obstruction is minimized. Moreover, the bureaucracy itself can serve as a constraint against potential defection by the leadership.

Team production and leadership[8]

The foundational leadership has to be alert to the bureaucratic question. It cannot simply establish the laws and institutions; it must also provide proper incentives for the staff.

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[8] This section draws from John Ahlquist and Margaret Levi's on-going work (Ahlquist and Levi 2008).

This involves leadership transparency and credibility based upon principles that are widely known and demonstrably enacted. Max Weber famously documented the structural conditions for the emergence of different kinds of bureaucratic structures (1968), and Herbert Simon provided an account of the individual decision making processes within the organization, given the cognitive limits of agents (1947). The emergence of the rule of law definitely depends on factors they identified, but the interactions between the founding leadership and their staff is what concerns us here. It is to the models economists have devised to explain the role of leadership in firms that we now turn for guidance.

Coase (1937) initiated the argument that the nature of firms and other forms of hierarchy involve a contracting problem between a principal (usually an employer) and an agent (worker, staff, or contractor). Much of this literature focuses on how optimal levels of effort (from the principal's perspective) can be elicited from agents under different information structures, levels of risk aversion, and more or less complicated organizational structures. A specialized version of the collective action/public goods problem, generally referred to as the "moral hazard in teams" or team production problem, is instructive of why firm leadership establishes certain kinds of institutional arrangements and why they continue to uphold them. The basic set up is like so:

1. There is a team consisting of *N* individuals.
2. Each individual can contribute some *effort* to the group project. Effort is costly and each person decides non-cooperatively how much effort to supply.
3. Each individual's effort level is *unobservable* and *unverifiable*. This effectively means that it is impossible to write a contract stipulating how much effort each person will supply. A related and usually implicit assumption is that agents cannot be coerced into supplying effort.
4. There is some function that determines what the total team output is given the cumulative effort. This team output is observable and can be contracted upon.

5. There is a stochastic component to the team production function that causes the productivity of team effort to vary according to some distribution. Agents must choose their level of effort before they learn the true value of the stochastic productivity component. It is therefore impossible to write a contract conditional on the realized value of this random variable. It is possible, however, to write a contract on an *ex ante* announcement by one of the team members as to the true value of the stochastic parameter.

6. A contract, then, is a series of payments to each individual member. These payments can be made contingent on the team-level outcome and/or the announced value of the stochastic component.

7. The final output of the team efforts must be completely divided up, i.e., the sum of the payments to the team members cannot be more or less than total output. This condition is referred to as the *budget balancing* constraint.

Holmstrom (1982) shows that, where there is a team production problem, there is no Nash equilibrium incentive contract that is both budget balancing and Pareto efficient. The intuition behind this result is that individuals will only contribute to the group project up to the point that their individual marginal gain is equal to their individual marginal cost even if their marginal cost of effort is far lower than the marginal team-level output.

Hermalin (1998, 2007) looks to the role of a leader to improve the situation. What happens if there is some member of the team that can learn the value of this stochastic productivity factor?[9] Clearly this information is valuable to everyone. The problem arises because this agent (referred to as the leader) has an incentive to lie. Hermalin considers two possible avenues the leader can pursue for credibly transmitting her valuable knowledge: "sacrifice" and "leadership by example." In the first, the leader makes a gift to the members out of her pocket. In the second, the leader exerts effort in order to influence others to follow suit. Both, if successful, motivate members to exert

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[9] Whether this agent learns the true value with certainty or simply has better information as to the distribution is irrelevant for the substance of his results.

themselves on behalf of the organization's project. However, "sacrifice" contributes nothing to the overall level of team production while "leading by example" contributes to and increases it.

The "sacrifice" solution is really just a mechanism design problem: is there a contract that will induce the leader to tell the truth and that makes the leader better off than the situation in which her knowledge is not utilized? Hermalin proves that there is. The gist of the result is that the optimal contract stipulates that in the high productivity state, the leader distributes some fixed amount to the other team members. This amount is just big enough such that a leader in the low productivity state has no incentive to copy. This solution relies on the enforceability of this contract and only allows the team to take advantage of the leader's superior knowledge; it does not overcome the team production problem. In this way, the "sacrifice" option is second best.

In the "lead by example" solution, Hermalin allows the leader to expend her effort before the rest of the team decides how much effort to contribute. By doing so, the leader signals to the team whether they are in a high or low productivity state based on her effort levels. Since this action is costly, it is credible, and a separating Bayesian equilibrium exists. The "leading by example" outcome is superior to the "sacrifice" option since the leader's action directly contributes to the overall level of team production.

The critical component underlying Hermalin's solutions is the transmission of information within the group, especially when leaders pursue the lead-by-example option. Members must be able to observe the leader's actions at low cost. Through repeat interactions between members and their leaders, leaders can build up reputations for credibility over time (Hermalin 2007). Those who begin their leadership roles already

embedded in a network of the organization's members are more likely to have the trust of members at the start (Ganz 2000). Those who make themselves regularly available to membership or make their decisions transparent are more likely to retain that trust.

By institutionalizing constraints on themselves, principled leaders exemplify the behaviors they want of others and provide information as to their type. Ceding final determination of budgets to legislators, constitutional term limits, and establishing an independent judiciary with enforcement capacity are among the institutional arrangements that both delimit the power of leaders and signal their accountability. The willingness of the leadership to bind its owns hands and ensure transparency of actions can gain them credibility with both staffs and publics.[10]

Earlier work on the firm (Barnard 1938) as well as more recent research that builds on Coasian insights emphasize that it is "…impossible for managers to realize the full efficiency potential of team production processes through the manipulation of short-term economic incentives alone" (Miller 1992, 198). They must inspire, and they must gain the confidence of those they are trying to motivate. The team production literature makes clear that the critical component is credible information and communication. Information transmission is crucial to the formation and modification of individual beliefs and affects the willingness of the staff to support leaders' policies (Arrow 1974; Levi 1997). Effective communication between the leader and those whose effort he is trying to elicit is critical for persuasion (Lupia and McCubbins 1998).

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[10] This follows a line of reasoning developed by Ferejohn 1999 and then by Alt 2002. Also see Levi 2005.

Corruption

The proposed solutions to team production problems presume that certain bureaucratic problems are already resolved, namely that procedures are in place to monitor and enforce staff behavior that would undermine relationships with those the bureaucrats are meant to serve. Team production improves the capacity of leadership to elicit effort and increase the loyalty of the staff to it, but it does not necessarily eliminate predation by the staff on citizens and subjects of the state. Corruption is the bête noire of the rule of law. Overcoming its prevalence among nineteenth century English tax collectors made it possible for the English state to win parliamentary approval and relatively wide-spread popular compliance with the income tax (Levi 1988; Brewer 1988). Similarly, in Hong Kong the ability of the government to establish effective anti-corruption efforts resulted in much higher levels of confidence in government (Manion 2004).

There are, of course, multiple reasons for corruption, and not all corruption is equal. As Merton pointed out long ago, some forms of corruption may actually grease the wheels of government in ways that better serve the public (Merton 1968 [1957]). He was talking about ward heeling and not the rent seeking or extortion detrimental to state effectiveness and trustworthiness. Devastating to the rule of law is high-level corruption involving huge sums of money a la Bangladesh or the hidden bank accounts of the Papa Docs of the world. But perhaps as important, particularly in the developing world, are the police and other local officials who form protection rackets, who threaten and thieve from those they are supposed to safeguard.

Solutions to high-level corruption require powerful actors within the polity who possess the political will and resources to make a change, often with the support of

international NGOs such as Transparency International or the World Bank.[11] Elimination

of predatory actions by local officials often requires an appropriate structure of payment

to street-level bureaucrats so that they depend on the state, rather than other sources, for

their incomes, advancement, and well-being. They can then come to calculate that they

are better off serving their clients than robbing them. At a minimum, they must receive a

sufficient salary from the state (Bates 2008). In post-communist contexts corruption

tends to be more prevalent when bureaucrats believe that their pay is below the cost of

living, which leads them to feel that corruption is a justifiably necessity, even when they

also consider it a social ill (Miller, Grodeland, and Koshechkina 2001).[12]

Corruption at every level of the bureaucratic ladder remains a serious barrier to the

establishment of a self-enforcing rule of law equilibrium. While corruption exists to

some degree in any state, the effects of systematic corruption are qualitatively different,

structuring interactions among state agents and between such agents and the populace

(Manion 2004). For higher-level bureaucrats, widespread corruption can be seen as a

signaling device, demonstrating to those at the same level of the hierarchy, as well as

those below, that any commitment expressed by a principled leader is at best quixotic,

and at worst fraudulent.

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[11] This is the current strategy in Bangladesh.

[12] Interestingly, such opinions were also reported by many respondents who were themselves not

bureaucrats, suggesting that little (or in some cases no) pay has an effect on attitudes toward

corruption throughout the populace.

Again, the experiences of Estonia and Latvia are illustrative, demonstrating the important role of well-defined and well-enforced sanctions on state officials and staff. In the first years of independence, Estonia adopted some of the most extensive regulations on corruption of any of the Eastern European countries seeking European Union (EU) membership. A series of high-profile prosecutions of bureaucrats for the abuse of office took place throughout the 1990s. Consequently, during the EU accenssion process, Estonia was widely regarded as being the least corrupt of all new member countries (Open Society Institute 2002). Latvia, on the other hand, half-heartedly embraced anti-corruption efforts, waiting a decade to enact real civil service reform and pursuing anti-corruption cases less than vigorously. Both high and low-level corruption remains widespread. Without clear and credible sanctions, even well monitored bureaucrats may be prone to deviant behavior. The benefits of corruption outweigh the costs if the costs are ill-defined or rarely imposed.

Perceptions of widespread corruption signal to each bureaucrat a low return from honest practices and from non-discriminatory enforcement of law. In such contexts, the honest bureaucrat will end up being a sucker, shouldering the burdens and receiving none of the benefits. Corruption also reduces citizen confidence in government whether it is practiced by visible high-level bureaucrats whose behavior citizens learn about in media accounts or the accessible low-level bureaucrats with whom they interact regularly (Miller, Grodeland, and Koshechkina 2001). Citizen perceptions of shirking, preferential treatment, and venality also negatively affect beliefs about the realization of the rule of law and undermine the possibility of a rule of law equilibrium.

Leadership-bureaucratic interaction

Principled leadership is not sufficient to obtain the rule of law, but it is an important component. By publicly shaming and punishing corrupt officials, principled leaders provide information about their own principles as well as their commitment to creating a rule of law.

Without principled leadership, the probability of obtaining bureaucratic respect for the rule of law is minimal.[13] Without principled leadership committed to rule of law reforms, the threat of sanctions for transgressions against the dictates of the rule of law will not be credible. Why would bureaucratic agents believe that the principal will expend the resources required to effectively monitor and sanction the bureaucrats for not complying with policies that the principal herself is clearly not committed to implementing?

ACHIEVING LEGITIMACY AND QVC

Legitimating beliefs about the state and the quasi-voluntary compliance that follows are essential to the successful establishment of the rule of law and to its maintenance over time. Public support and conviction that it is normatively appropriate to obey the law, ceteris paribus, transforms a coercive into a rule of law regime. But legitimating beliefs are a consequence of other prior factors, most importantly the credible commitments of principled leadership, bureaucratic performance and integrity, and institutional

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[13] Manion (2004) discusses this with regard to anti-corruption efforts in Hong Kong and the People's Republic of China.

arrangements that ensure the continued observance by leaders and bureaucrats to the principles of the culture of law they are trying to realize.

How populations develop such perceptions and beliefs is not always straightforward, however, particularly when there are multiple groups within the polity. Again, leadership plays a critical role in establishing a common set of values—or not. Shared social norms of a group offer guidance to members about whether to consider deference or resistance to authority. The group also creates a setting in which its members develop a sense of reciprocity towards each other, making them more likely to conform with each other and less likely to free ride on the others' efforts. When a group perceives the leaders and bureaucrats of a state as unfair and discriminatory—or worse— it is likely to develop a normative stance of defiance. Shirking obligations, vandalism, and even armed struggle can result, and the rule of law becomes far more difficult. The francophones in Canada, the Irish Catholics in Northern Ireland, the Basques of Spain are recent examples from the developed world. India still experiences communal riots, sixty years after Partition. Ethnic, religious, linguistic, and racial conflicts are constantly tearing apart countries with less governance capacity.

Those countries that can both experience strong tensions and maintain the rule of law have several features in common. First, they have constitutions and constitutional histories in which actual negotiations took place to ensure that all participating parties had protection under the law.[14] In India, this involved granting special rights to Dalits and others who had previously enjoyed no civil rights. In Canada and the United States, it

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[14] This is an empirical claim we need to explore further.

produced forms of federalism to protect sectional and regional interests. Second, they had leadership that produced organizational cultures based on principles of relative equity and fairness. Such leadership facilitated the original constitutional negotiations, acted to obtain the initial cooperation of powerful elites, and then designed institutions that ensured that cooperation over time. Finally, these are countries whose institutions and leadership continue to exhibit the capacity to reform institutions to incorporate new actors and new understandings of appropriate law while, simultaneously, maintaining a commitment to the core values that initially stimulated building the rule of law. The combination of principled leadership and reasonably well-designed institutions give citizens confidence they are dealing with a trustworthy and legitimate government whose authority they feel obligated to obey.

Institutions are not sufficient on their own. It is principled principals who design, transform, and breathe life into them, and it is bureaucrats and citizens who uphold them. It is principled principals whose leadership by example signals to the elites, the staff, and the populace the nature of the world they inhabit and the reasons for complying with the rule of law.

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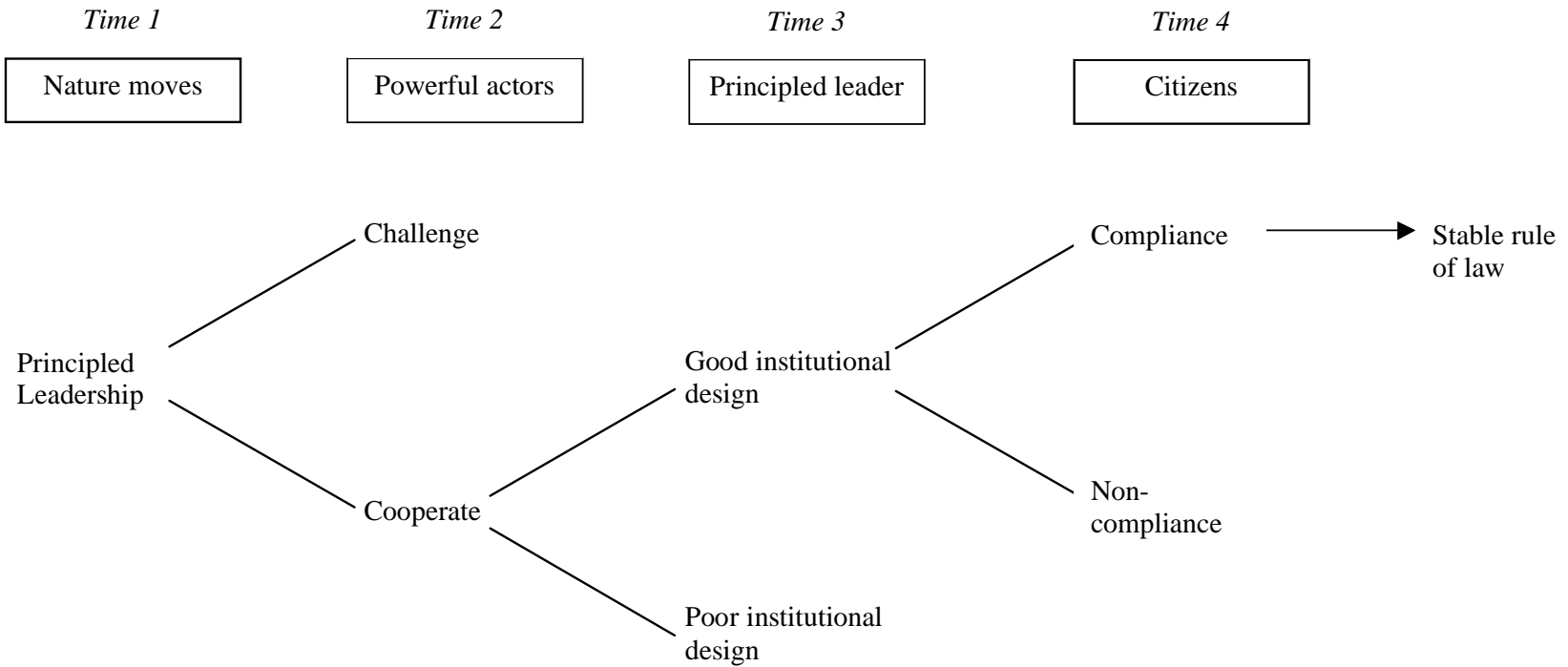Zald, Mayer N. 1970. *Organizational Change*. Chicago: University of Chicago Press.

FIGURE 1: A model of the process of establishing the rule of law, given a principled first mover.