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## When is ordinary law-making tolerated?

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### Abstract

Institutions matter: they affect individual action, influence cooperation, and are crucial in making the difference between wealth and poverty, growth and stagnation. Yet, the explanatory power of modern institutional theorizing has not been exceedingly satisfactory.

In contrast with the mainstream perspective, this paper suggests a theory of institutional dynamics based on the notions of justice, liberty, and tolerance. In particular, we put forward a stylized model of society, within which individuals are characterized by their ideological traits. We discuss under which conditions tensions emerge, and when demand for institutional change builds up. We conclude that today's democracies are inherently stable, and that this stability is explained by the socialist notion of liberty that characterizes the vast majority of the population of a typical modern society.

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### 1. From institutions to legal rules

Institutional analysis has always played a key role in political science and sociology. On the one hand, the historical school of political science has depicted institutions as "procedures, routines, norms and conventions embedded in the organizational structure of the polity", the purpose of which is to define authority and contain conflicts (Hall and Taylor, 1996: 938). In this view, institutional resilience and path-dependence are explained by the actions of the coalitions in power, which rationally try to preserve their prerogatives by making change through ordinary law-making difficult; and also by the presence of cultural elements, as a consequence of which institutions are shaped by the individuals' visions of the world, visions that are in turn affected by the context within which individuals operate and develop their beliefs and opinions, particularly about social goals and about the purpose and scope of government (Steinmo, 1992). On the other hand, sociologists maintain that institutions are ultimately the expression of the community's shared beliefs (Berger and Luckmann, 1966). Thus, sociological institutionalism lays considerable emphasis on people's perception of the existing system of laws, government agencies, and procedures, and analyzes the possible tensions between the moral standards of a society and the formal and informal structures in place within that society.

Despite their numerous points of contact, however, the historical and the sociological views have originated two different research agendas. Historical scholars have been trying to assess what kind of shocks interrupt a path-dependent process and how the actors involved react to shocks. By contrast, the sociological context has been discussing the notion of legitimacy, which ensures that the individual recognizes an institution as the source of authority and is ready to comply.

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The economics profession has also been aware of the importance of the institutional dimension. As Adam Smith pointed out over two centuries ago, institutions affect individual action, influence cooperation, and are crucial in making the difference between wealth and poverty, growth and stagnation.<sup>1</sup> Not surprisingly, therefore, speculation about the role and purpose of the "humanly devised constraints that shape human interaction" (North 1990: 3) has generated a substantial literature.<sup>2</sup> From the institutional perspective, however, the real challenge is not about searching, designing, and maintaining the best institutions. Rather, it is about explaining why individuals tolerate and possibly support the institutions they have, even when those institutions have failed to deliver the expected results - say in terms of material wealth or income growth. And it is about investigating what moves them to look for substantial institutional change.

In this paper we abandon the traditional institutional analytical agenda and focus on the last two questions - institutional tolerance and institutional tensions<sup>3</sup> -- by framing an interdisciplinary approach that draws from the traditions of political-science, sociology, and economics.<sup>4</sup> In this section we argue that tolerance for the existing order originates from the individual's evaluation of the current system of legal rules, which are judged according to their ability to obtain desirable goals and to respect one's deontological principles. Section 2. explains to which extent people are willing to tolerate deviations from their ideal institutional environments, while section 3. analyzes how different groups of individuals react to the tensions created by excessive deviations (the liberty gaps). Following from this, section 4. puts forward a theory of institutional dynamics based on ideological change, and section 5. concludes.

## 1.1 Grand principles and ordinary law-making

We begin our investigation by distinguishing between 'grand principles' and 'ordinary law-making' (Hayek 1960, Ménard 1995). Grand principles are deontological concepts and correspond to shared beliefs about 'fundamental rights' ('justice' and 'fairness' - these terms will be used interchangeably) that may or may not be detailed in formal documents. For example, most individuals within a given community would agree that all the members of the community should be free from need. This principle is often mentioned in official documents (constitutions) as a generic social commitment to solidarity and is a principle to which few citizens would object. Yet, grand principles need to be made operational. To this purpose, ordinary laws are created to fill in the details and transform principles into actions. Thus, ordinary law-making gives substance

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<sup>1</sup> Adam Smith underscored the role of institutions both in *The Theory of Moral Sentiments* (e.g. in Part III) and in the *Wealth of Nations* (e.g. in Book V). See also Buchanan (1976) and Elser (1989) on the Smithian insights into institutional analysis.

<sup>2</sup> See for instance the surveys and references suggested in Hodgson (1989, 2004) and Sen (2009: Introduction). See also Hodgson (2000), who emphasizes the vantage point of the old-institutional scholars (from Veblen to Hamilton and Galbraith).

<sup>3</sup> In this paper 'institutions' are a 'system of legal rules'. Thus, institutional tolerance and tensions refer to people's attitudes towards the system of legal rules in place.

<sup>4</sup> A similar methodological approach has been suggested by Thelen (2003), and has been later used by Gilley (2008) in order to identify three different traditions - economic institutionalism, socio-political institutionalism and historical institutionalism - and to put forward a "legitimacy-based approach". However, Gilley's notion of legitimacy is narrower than ours.

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to the generic notion of poverty relief and enforces redistribution, by imposing suitable taxation, and by establishing and funding agencies responsible for managing poverty-relief programmes, including the distribution of merit goods and outright transfers of money.

## 1.2 Tolerance

Conformity to grand principles defines the effectiveness and legitimacy of ordinary legal rules.<sup>5</sup> Of course, in an ideal world, all ordinary institutions are perfectly congruent with one's sense of justice and thus perfectly legitimate. Yet, reality is never perfect, and individuals are aware that the quest for perfection is vain and understand that tolerance of deviation from an ideal is an ingredient of peaceful cohabitation. For the purpose of this paper, we suggest that this tolerance depends on three variables. The first relates to the individual's perception of the social covenant (social legitimacy), i.e. of the moral standards that one believes are shared by most members of the community. In particular, tolerance is enhanced when the individual perceives that he is part of a cohesive community founded on widely shared principles: in other words the content of the social covenant is relatively well defined. Thus, the individual accepts and respects ordinary laws consistent with the implicit, recognizable covenant characterizing that community, even when these shared standards do not totally coincide with his own.

The second variable relates to conformity with the rule of law (procedural legitimacy), i.e. to the policymakers' compliance with the prescribed, agreed-upon procedures, independent of the substantive desirability of the law (Mueller and Landsman 2004). This is frequently the case in mature democracies, in which majority or super-majority decision-making procedures prevail and are accepted as legitimate even when consistency with the grand principles appears doubtful. Under these circumstances, the greater is the role of procedural legitimacy, the greater the importance of the electorate as judge of the policy-makers' right to legislate. Once one accepts to play according to given rules, and such rules are applied fairly and consistently, withdrawing from the social contract would be unjustified.

The third variable is civility, which refers to instinct, education and experience, and which implies consistency with the behaviour that one expects from the other members of his community. Put differently, civility characterizes the individual's perceptions of the interactions among the various members of the community, which can meet the standards of honesty, charity and mutual trust, or which can come closer to the Hobbesian perspective on human nature (hostility, possibly accompanied by violence). A community lacking civility is a community the members of which hardly respect each other, are prone to cheating, are inclined to take advantage of people's weaknesses or carelessness, and frequently decline to offer disinterested help. In other words, a group of people featuring a quasi-Hobbesian state of nature show that they do not believe that they should comply with any code of fair behaviour and that most attempts to cooperate will be stifled. Clearly, lack of civility is different than breaking ordinary laws and thus might not involve sanctions, but loss of reputation. Yet, the

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<sup>5</sup> The political-science literature has coined the concepts of "affective support" and "diffuse support" in order to characterize people's attitude towards current institutional contexts. Thus, legitimacy is "defined as a person's conviction that the system conforms to his/her moral or ethical principles about what is right in the political sphere" (Muller et al., 1982: 241). See also Berggren et al. (2013) for a recent contribution to the economics literature.

lower the degree of civility in a society, the fewer the possibilities for fruitful interaction (not only in material terms) and the more individuals feel uncomfortable about an institutional context that is unable to enhance cooperation with a view to obtaining common goals.

## 2. Liberties, tolerance and institutional stability

Following from our emphasis on the role of legitimacy, therefore, in this section we study how humans perceive the institutional context; while we devote sections 3 and 4 to exploring the dynamics of institutions and the mechanics of institutional interaction. Section 5 concludes by taking stock and reassessing the agenda for future research in the realm of institutions.

### 2.1 Absolute and civil liberties

As mentioned earlier, beliefs about justice play a significant role in the development of the individual's social preferences and his assessment of legal order. In particular, we posit that each person elaborates his own notion of justice by following two different criteria. The first criterion is defined by the range of rights that he feels are innate to human nature, that belong to him from birth and upon which nobody should encroach. Blackstone called these rights the individual's set of "absolute liberties". Of course, different individuals may have different opinions about the content of these absolute rights. For example, some people might think that they have no rights other than those produced and assigned by the state. By contrast, others might believe that each individual has a right to physical integrity, freedom of movement and unfettered private property,<sup>6</sup> no matter what ordinary law-making prescribes.<sup>7</sup>

Yet, there is no guarantee that one's absolute liberties are respected. For example, although most people would agree that cheating and mugging someone are violations of the victim's absolute rights, individuals are still vulnerable to criminal misbehaviour. Put differently, when we enter a community - or assess our role within the society in which we happen to be born - we pursue two different goals. We aspire to enjoy the absolute liberties to which we believe we have a right; but we also realize that our absolute liberties cannot be fully enjoyed unless they are properly protected (Locke, 1689a/1764: 148 and 1689b/2010: 12) and that orderly interaction with the other members of the community is instrumental in obtaining our happiness (Humboldt 1852/1993: 10-11 and 27; Granovetter 1985). In a word, we are ready to accept cooperative agreements to ensure protection and enhance our human potential, even if this might require some compromise. That explains why most people are willing to join a community, follow its rules, and give up some of their absolute rights.

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<sup>6</sup> See Blackstone (1753/1893: vol. 1, chapter 1) and also Humboldt (1852/1993: 6), who referred to "the freedom of private life".

<sup>7</sup> It has been suggested that one's notion of liberty could be explained by his opinions, rather than by his views of natural rights, and thus could be modeled as a knowledge problem. The point is well taken. We insist on natural rights, however, because in our context, individuals believe that their understanding of liberty rests on natural rights, rather than on opinions; and that, therefore, the political authorities have no rights to impose compromises. Put differently, a political authority just needs broad consensus in order to disregard an opinion, but it needs explicit individual consent to violate a natural right. Hence, arbitrary disregard for an opinion does not involve a loss of legitimacy, whereas arbitrary violation of a natural right does.

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The second criterion an individual uses in developing his own notion of justice is "civil liberty, which [...] is no other than natural liberty so far restrained by human laws (and no farther) as is necessary and expedient for the general advantage of the public" (Blackstone, 1753/1893: vol. 1, chapter 1). In accordance with Blackstone, therefore, we call civil liberty the bundle of rights left to the individual once he becomes part of a society, rights that are in fact strengthened (i.e. enforced more effectively) as a consequence of government intervention. In this context, we assume that the state is the main producer and enforcer of those human laws that end up restraining Blackstone's absolute liberties. Clearly, the smaller is the set of civil liberties, i.e. the absolute liberties the individual can enjoy after the introduction of laws, the greater the role of government.

To complete our line of reasoning, we suggest that desirable state intervention is not only instrumental in guaranteeing one's absolute liberties and defining the extent of one's civil liberties, but that the nature and quality of government intervention also affects economic performance. Put differently, legitimacy requires that government intervention focus on the areas deemed legitimate by the population: for example, extensive government intervention might be appreciated when it enhances the production of public or merit goods, less so when it engages in arbitrary redistribution or bad projects, or when it distorts incentives through unjustified subsidies and barriers to competition. When economic performance worsens, tensions might emerge, since individuals believe that the cost of government encroachment is too high and that the institutional context must be reconsidered.

## 2.2 Two extreme views

If one observes the real world, one can argue that a society generally includes individuals possessing different notions of absolute liberty and also varying propensities to compromise on their absolute principles, for the sake of economic performance and/or to enhance the enforcement of their fundamental principles. In particular one can imagine that people are aligned between two extremes - the libertarian and the socialist.<sup>8</sup>

According to the libertarians, the notion of absolute rights is encapsulated in Blackstone's list of absolute liberties. These individuals realize that they need an agency with the power to protect their physical integrity and property rights, and to enforce contracts. They realize that once the security agency - call it "government" - starts operating, it might take advantage of its powers and engage in activities that go beyond what is needed to provide security and contract enforcement. Yet, the libertarians may deem that this is a cost worth paying, as long as abuse remains within limits. In other words, if government intervention is moderate, the libertarians are happy to bear the

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<sup>8</sup> A libertarian view is anchored to the freedom-from-coercion principle. In brief, according to the libertarians nobody has the right to force individual A to act against its own will, unless individual A is bound by an explicit contract. Thus, this general principle rules out physical aggression, cheating and encroachment upon private property. By contrast, the socialist view holds that the collective interest prevails upon the private interest and that, therefore, a legitimate authority can disregard individual preferences and force the individual to act in accord with the goals pursued by the authority. Our libertarian/socialist dichotomy echoes Humboldt (1852/1993: chapter 1), who distinguished between the minimal state, which aims at securing individual freedom from coercion and possibly contract enforcement; and the modern state, which acts on behalf of the individual citizen and provides for his welfare by producing selected goods and services and enforcing redistribution.

cost of diminished absolute liberties, because the civil liberties they enjoy create more opportunities to be happy and enhance their material wellbeing (economic growth) than the liberties they would enjoy in isolation. By contrast, if rent-seeking is substantial and economic performance trails off, libertarians feel that the sacrifices they incur in terms of absolute liberty are unjustified, and the demand for civil liberties is greater.

At the opposite end of the spectrum is the socialist stereotype, according to which society needs significant government intervention in order to compensate for the presence of market failures and income inequalities. From this perspective, therefore, although a socialist society would end up with a relatively low degree of civil liberties, its members find that their ideal of justice is satisfied, since social efficiency and equality clearly need regulation and redistribution. Of course, an environment in which legislators take advantage of their prerogatives and encourage wastages would be problematic. Yet, this outcome would not raise major doubts about the role and size of government; rather, it would merely elicit reform, so as to make the current rules more effective. In other words, a socialist would not question the role of government and would rationally accept disappointing growth if this is the price to pay to obtain equality and to make selected merit goods available. Hence, reform would focus on closing loopholes and remedying scandalous situations, rather than changing the role or the goals of legal rules.

### 2.3 Liberty gaps, tolerance and economic performance

Let us now turn to individuals' attitudes towards the prevailing institutional context. We have observed that a population is composed of groups of individuals whose preferences vary between the libertarian and the socialist extremes. It follows that, except in highly homogenous communities, the civil liberties characteristic of a democratic society are necessarily the result of an arrangement according to which the majority of the population agrees on a tolerable compromise, so that the liberty actually enjoyed by each member of the community probably differs from his ideal, but is still preferable to the alternatives - a worse compromise or no compromise at all (the Hobbesian state of nature). We shall henceforth identify the difference between the actual and desired civil liberties as the 'liberty gap'. Given the actual civil liberties, therefore, the liberty gap depends on one's notion of absolute liberty and - especially for those individuals close to the libertarian ideal -- on economic performance.

Tolerance is what makes the liberty gap acceptable and contributes to making a society stable by reducing pressure for institutional change. When tolerance is great enough, individuals are satisfied with their condition: they believe that they are living within a shared social covenant, that the government is not abusing its powers. In other words, tolerance is embedded in the assumptions that give rise to political life and for which the social covenant is instituted: it draws both on the Hobbesian view according to which the liberty gap is the cost the individual must bear in order to secure greater advantage; and on the Lockean claim that men are also driven by their feelings of a moral commitment towards other men, despite their differences.<sup>9</sup>

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<sup>9</sup> See Gauthier (1977), who draws attention to Locke's vision, according to which morality means consistency with the divine law, expressed in the law of nature; and Locke's *Second Treatise of Government*, in which he argues that "the first and fundamental natural law [...] is the preservation of the society, and (as far as will consist with the public good) of every person in it" (chapter XI, §134) and "A man, as has been proved, [...] having in the state of nature no arbitrary power over the life, liberty or possession of another, but only so much as the law of nature gave him for the preservation of himself

### 3. The libertarian and the socialist reactions to tensions

Let us now explore some implications of the analysis suggested in the previous section. It is clear from our reasoning that tolerance is crucial. In particular, its absence might generate cumulative phenomena, since the individual's tolerance also depends on his perception of the others' attitude: if everybody cheats, one might be less inclined to be honest, to abide by the rules, and to respect institutions. In section 1.2 we pointed out that tolerance depends on social and procedural legitimacy of government action, as well as on one's perception that most of the other members of the community are civil. In other words, when people observe that they are living in a community characterized by legitimate institutions and civility, they feel encouraged not to betray trust (no cheating, no free riding, limited rent-seeking) and they also feel it is their duty to monitor and publicly expose wrong behaviour. As a result, tolerance increases further and becomes a self-reinforcing mechanism. By contrast, if misbehaviour is widespread and the institutional context is discredited, trust is eroded and the cost of flouting the rules drops:<sup>10</sup> why should one be honest and run the risk of being tricked or deceived while everybody else - including government authorities -- is misbehaving?

In order to investigate the implications when tensions emerge, we distinguish between the reactions typical of the layers of the population closer to the libertarian camp from those of those characterizing individuals closer to the socialist view.

#### 3.1 The libertarian reaction

Following from the line of thinking articulated in the earlier sections, tensions emerge if an ideological shock and/or unexpected poor performance broaden the liberty gap.<sup>11</sup> In particular, instability arises if the shocks or poor economic performance occur when tolerance is relatively low. When this happens, tolerance is likely to fall further, the policymakers shorten their time horizon and possibly engage in more intense rent-seeking: economic performance suffers, and the liberty gap widens further. As mentioned above, speed matters and less than radical responses might not be enough to redress the situation. But if enough people really believe that radical change is required, radical change does take place.

The above mechanism is self-evident when the shock originates from an ideological change following which individuals resent government intrusion to larger extent. The role of the liberty gap is also apparent when tensions originate from poor economic performance. True, if economic outcomes are only occasionally disappointing (due, for example, to cyclical crisis), the liberty gap is not going to be affected, insofar as agents are tolerant enough to absorb the shock. Thus, the members of the society who cherish absolute freedoms and are more demanding in terms of economic performance are unlikely to advocate radical changes in the legal rules. When crisis presents structural

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and the rest of mankind" (chapter XI, §135).

<sup>10</sup> This point had already been noted in Adam Smith's *Wealth of Nations* (Book V.ii.f and k). More recently, Zak and Knack (2001: 317) show that "cheating is more likely (and trust is therefore lower) when the social distance between agents is larger, formal institutions are weaker, social sanctions against cheating are ineffective".

<sup>11</sup> We remind the reader that the liberty gap is a function of the difference between desirable and civil liberties, as well as of the difference between actual and expected economic performance (see section 2.3).

features, however, the liberty gap that these individuals are willing to tolerate shrinks. If legitimacy or civility is insufficient, pressure for change occurs. Similar to the previous case, if the attempts to revitalize economic performance are timely and successful, equilibrium is restored. Otherwise, demand for institutional change builds up, and the social environment rapidly deteriorates.

### **3.2 On socialist behaviour**

In the previous paragraphs, we have argued that societies in which liberal views prevail are stable when they rely on a significant stock of tolerance: tolerance cushions cyclical changes in economic conditions and relatively small alterations in the ideological climate. Can one make the same claim for the members of a socialist community?

As pointed out in section 2.2, for our purposes the liberal and socialist perspectives diverge in two respects. First, their notion of absolute liberty differs, so that the size and - most importantly - the direction of their liberty gap is not the same: while in a libertarian context, the institutional environment might be delegitimized by excessive government intervention and insufficient liberties, the opposite holds true in socialist societies, who believe that justice is enhanced by government intervention and by curtailing some individuals' liberties in the name of equality. Furthermore, when economic performance slows down, a society in which the liberals prevail reacts by advocating de-regulation and more liberties in order to reduce the greater liberty gap. By contrast, a society featuring socialist traits reacts by advocating improved policy-making, a more effective bureaucracy, and more rigorous monitoring. In other words, since a socialist vision gives priority to the welfare state and redistribution, it takes a long time before stagnation or recession undermine the legitimacy of the institutional framework. From his vantage point, therefore, tensions emerge because of disappointment with performance, not because pervasive and intrusive rule-making is "bad" or perceived differently than before.

From the extreme socialist perspective, therefore, institutional stability can only be threatened by ideological change, as a result of which the agents come closer to the libertarian view or advocate a greater role for government intervention, depending on the direction of the change. Certainly, when the shared ideology changes, the current institutional context can seem inadequate. For example, if people require greater income equality and stricter regulation, the liberty gap widens and the search for rents and guarantees intensifies, to the detriment of economic performance. Contrary to the libertarian case, however, an increase in rent-seeking and a decline in performance do not affect the rules of the game, which prove resilient (stable). People might be unhappy about the state of the economy, since everybody would like to be better off. Yet, unless further ideological change occurs, pressure for institutional change is going to be weak. Pressure will be for the government to do more to remedy perceived problems, but there will be no demands to change the vision of what the government does.

## **4. Interaction and change**

The upshot of the previous two sections is straightforward. In most societies, the rules of the game to which individuals voluntarily subscribe necessarily feature a mix of civil liberties positioned between the ideal desired by the libertarians and that sought by the socialists. Compromise and institutional stability are guaranteed if the liberty gap is bridged by tolerance, i.e. if the social contract is clear enough and most of the



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population plays according to the agreed-upon principles of social and procedural justice. When these requirements are met, people recognize the legitimacy of the institutional context, peacefully cooperate, and pursue their own visions of happiness. Tensions might surface from time to time, but they tend to play a minor role, since most members of the community sincerely believe that they should content themselves with what they have and that institutional change would be unlikely to better their condition.

In partial accordance with the historical literature, therefore, one could indeed argue that a society that is initially stable is bound to remain stable unless hit by a shock that delegitimizes the institutional context because the grand principles have changed. Thus, such a society follows a path-dependent process (inertia), in that ordinary law making consists in accommodating to the last shock, until something new occurs (Young, 1996). Certainly, the legislators might also introduce adjustments in response to technological innovation or cyclical fluctuation, or as a result of the political quest for consensus. If the society's grand principles and the notion of liberty are constant, and if law-making adjustments do not affect the civil liberties enjoyed by the population, the underlying element of tolerance is strengthened and the social structure becomes more resilient to shocks. By contrast, if policymakers do get carried away and interfere with civil liberties, and if tolerance is thin, then tensions come to the surface, with possible cumulative effects.

Thus, absent serious ideological crises, which are the core of the sociological approach, in our perspective the critical element leading to the emergence of possibly serious institutional unrest is the presence of a large enough group of individuals receptive to the libertarian view on government, more sensitive to the link between economic performance and institutional legitimacy, and therefore more inclined to ask for institutional change even when the shared notion of justice stays constant. The implication is that when the libertarian component is weak, society is stable even in the presence of economic crises: it requires disaster or virtual disaster before the underlying nature of the legal rules is questioned.<sup>12</sup>

Our analysis also suggests a few additional conclusions: First, ideological minorities do not pose major social problems for communities characterized by a clearly identifiable social covenant with which the population complies spontaneously. Put differently, as long as the social contract is clear, rent-seeking is contained, and everybody plays according to the rules of the game.

Second, stagnation or recession is certainly likely to provoke widespread resentment, but it brings about institutional crisis only when the libertarian component is substantial and tolerance dwindles. Under such circumstances, a community closer to the libertarian ideal would undergo structural change, while a socialist-oriented community would press for better regulation and monitoring in order to attain existing goals.

Third, finding an institutional solution to unrest becomes critical when the liberty gap is large and tolerance -- legitimacy and/or civility -- is weak. This becomes even more problematic when such a society is also fragmented into many groups and loyalty to the group is more important than overall community cohesion. Then, the fragility of the social covenant becomes apparent, and respect for its clauses is weak. At that point, two outcomes can emerge. Some groups may end up hoping to exploit the system to

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<sup>12</sup> This possibility had already been conceived by Tocqueville (1835-1840/2010: 1261). See also Berggren et al. (2011) on the relation between stability and growth.

acquire privileges (slick conformists); or rent-seeking becomes such a drain on the economy that the advocates of social justice revise their position and eventually accept free-market reforms to revive economic performance.

All in all, we admit that the dynamics of ideological change – and thus legitimacy – remain hard to define. As we have argued elsewhere, however, we believe that shared beliefs are almost exogenous. Although people are indeed influenced by what they see around and what they have inherited from the past, genuine ideological change is a very rare event and requires momentous shocks that radically affect the way people perceive the role of the individual in a social context. Typical examples were the Gregorian Revolution in the late eleventh century<sup>13</sup> and the Thirty Year War in the seventeenth century: the first sparked the debate on the source and legitimacy of the political authority, whereas the latter undermined the foundations of the divine order on earth.<sup>14</sup>

Although generalizations are often deceptive, we suggest that Western societies are presently under the influence of the ideological change sparked by the World War I, as a result of which for most people the notion of absolute liberty has come relatively close to the socialist ideal. As witnessed by the increase in government expenditure and regulation that has characterized the past decades, it appears that the vast majority of the population in much of the Western world is fairly happy with a limited version of absolute liberty. In other words, most of us are close to the socialist end of the spectrum and not inclined to question the current view on social justice, no matter how disappointing economic performance might be. As result, today's modern societies feature a rather limited liberty gap and, thus, the willingness to change the role of government is fairly small. Government intervention therefore turns into a matter of fine tuning, but its scope and nature are not really doubted. In this light, investigating the drivers of institutional change in a society by looking at grand principles does not pay.

Rather, the challenge faced by the social scientist is to assess what kind of shocks can break inertia and how to articulate the mechanics of unwarranted change. To repeat our earlier point, tensions do not necessarily generate a new approach to ordinary law making, although they might create opportunities for populism and rent-seeking. The traditional institutional literature remains rather vague on both points. We have tried to make some progress by suggesting that tolerance with respect to the liberty gap is decisive to trigger institutional crisis, and that this gap is defined by legitimacy and civility. Put differently, discomfort with the current state of affairs might bring about tensions and discontent and the implicit social bonds that constitute the essence of social cooperation might be shaken. Yet, discontent about one's own situation does not necessarily imply that one elaborates or imagines a new vision on the nature and purpose of legal rules inspired by a consistent vision of liberty and individual responsibility. In fact, discontent must be deep enough to overcome the institutional

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<sup>13</sup> The Gregorian Revolution is named after Pope Gregory VII, who challenged the primacy of the secular ruler and raised the question of legitimate power. The debate that followed involved inquiries into “the notions of natural order and divine will on the one hand, and the assessment of the nature and goals of the individual within society on the other” (Colombatto, 2011: 83). See also Berman (1983, chapter 2).

<sup>14</sup> It might be observed that the term "shock" is in fact rather misleading, since it conveys the idea that change takes place rather rapidly, in a few days or weeks. In fact, ideological shocks may take decades or even centuries to unfold. For instance, the full consequences of secularization became visible only in the nineteenth century.

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transition costs (broadly understood). Moving from one set of institutions to another is not easy, since obsolete legislation must be scrapped, a new consensus must be found, new laws passed, and one is never sure about the outcome, which might easily differ from expectations. In the end, unless the liberty gap reaches a critical threshold, and unless uncertainties and inertias are overcome, the outcome is conformism, grumbling and rent-seeking, while existing institutions adjust at the margins, with no substantial change.

## 5. What do we make of institutional economics?

This article is inspired by the belief that individuals' attitudes and willingness to interact, exchange and cooperate are not entirely the outcome of a common evolutionary story. Our very nature as human beings presumes our ability to choose whether to give in to our instincts and emotional drives, or rather engage in rational sets of actions, possibly restrained by value judgments (morals).

A similar line of reasoning holds true for the institutional context: legal rules do not emerge spontaneously,<sup>15</sup> nor are they accepted independently of what they mean and imply. Value judgments and rational compromise feature prominently in the emergence and acceptance of legislation and we suggest that all stable, complex institutional arrangements are characterized by ideological components. Following from this, we have argued that the political science, the sociological and the economics literatures have much to say, but none of them taken in isolation can articulate a fully satisfactory explanation of what we observe. For example, Chen et al. (1997) developed an index of legitimacy for China, and concluded that although the Chinese were not particularly happy about the economic performance of their country, they thought that the institutional context was satisfactory - a result also confirmed by Gilley (2008), with some qualifications. Hence, the authors conclude that the institutional system is stable. Yet, from the standpoint suggested in the present paper, this information is incomplete and the conclusion unwarranted. In particular, the crucial question is not whether the Chinese institutional environment is stable, but how performing the economy must be in order to avoid tensions, whether the Chinese society can really be considered ideologically homogeneous (as the authors assume), and what drives institutional change and in which direction.<sup>16</sup> From a different angle, the literature has been investigating the connection between economic performance and regime change - say democratic breakdowns as a result of economic crisis (Gasirowski, 1995). The results obtained are ostensibly inconclusive: we suggest that economic performance alone says little, if it is not analyzed in terms of institutional tolerance/legitimacy.

In particular, in this paper we have tried to analyze the nature of institutional tensions and the consequences these tensions might generate. We have pointed out that, when unrest comes to the surface, policy-makers can react by following different patterns. They can operate at the margin by adjusting ordinary law-making and keeping the liberty gap within tolerable limits, in order to diffuse pressures. Or they could acknowledge the existence of a new context of grand principles and engage in deep

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<sup>15</sup> Of course, institutions might be the unintended result of the agents' actions. But this does not mean that they emerge spontaneously. For example, informal rules are the product of repeated intentional actions, while formal rules are often the result of a conscious decision by the law-giver.

<sup>16</sup> Of course, the new-institutional economist would say that the driver is economic performance. See however Przeworski (2004) for a word of caution.

change. Generally, however, populism, expediency, and marginal adjustments prevail in fragmented societies, and the grand principles are very rarely questioned. Individuals might feel frustrated in their efforts to improve their condition, and they might be aware that the current body of laws is responsible for the lack of opportunities and disappointing economic conditions. Yet, lack of agreement on a new, widely shared ideological structure prevents new notions of social justice from emerging and overhauling the institutional context. This is particularly true when the cost of transition remains uncertain; it is magnified in societies with a socialist tradition, in which the sense of individual responsibility is modest, solutions usually follow a top-down process, and bureaucrats or technocrats, who are usually confronted with circumscribed, operational problems, are asked to come up with new visions of the world; and can be further aggravated when the population is quickly aging, since elderly people would surely suffer from the bumps involved in transition, while the benefits would be relatively short-term. To repeat, unease and tensions do not necessarily lead to crises. When tolerance for the liberty gap is deeply rooted, institutions can still be accepted despite their social legitimacy having dwindled. On the other hand, when discontent is significant, the extent to which it degenerates and society becomes vulnerable to rent-seeking pressures marks the difference between relatively rich economies (in which rent-seeking is limited or highly inclusive),<sup>17</sup> and communities featuring large pockets of wasteful privileges, in which cooperation is biased towards personal relationships and the opportunities offered by impersonal exchange are overlooked.

Moreover, our view has emphasized that the debate on the role of tolerance should always be framed in the light of the existing liberty gap and, therefore, in terms of ideological perspectives, legitimacy and civility. True, today's prevailing emphasis on the pragmatic role of institutions<sup>18</sup> seems to strengthen a view according to which legitimacy is indeed a question of material outcomes, rather than of compliance with moral standards. Advocates of the so-called "Veneer Theory", for example, hold that morality is just a hypocritical layer covering up men's purely rational, self-interested core (Wright, 1994). We do acknowledge that for most people the notion of morality might be a little vague and that for a substantial number of individuals fundamental principles boil down to the (absolute) right to physical integrity and a generic right to solidarity, the rest being subject to debate and negotiation. But we also agree with De Waal (2006), who maintains that individuals do have a more or less sophisticated sense of morality. It originates from an evolutionary process that combines passions, emotions and instincts; and it gives substance to the Smithian "impartial spectator", who allows us to make value judgments about potential goals and behaviours, and to transform subjective judgments into general rules also applicable outside the community to which we belong.

In this vein, the economists' traditional view about how to analyze the evolution of legal rules might need to be reassessed. True, the dynamics of ordinary institutions is

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<sup>17</sup> In accordance with Olson (1965), inclusive rent-seeking refers to large coalitions, whose activities are likely to produce only limited externalities.

<sup>18</sup> Neglect of the transcendental vantage point is consistent with mainstream (neoclassical) economics, as well as with the position held by influential thinkers. For example, in the early 1940s Frank Knight advocated the discovery of morality through discussion (van Horn and Emmett 2011). In a similar vein, although from different quarters, Amartya Sen held that justice should be defined by rationally debating its content, starting from a broad enough definition and keeping only those elements that do not solicit substantial objections. It might be worth pointing out that common to these lines of thought is that morality is ultimately to be defined by intellectuals.

powered by the interaction between concerns for efficiency and pressures from different interest groups; and is also influenced by significant institutional costs (inertia). Still, the kind of game and the playing ground that determine the range of actions and reactions are to be defined at a higher level. Neglect for this component runs the risk of transforming institutional analyses either into empirical exercises in *ex-post* determinism, or into generic models according to which everything depends on everything.

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