

**Limited Access Orders:  
Rethinking the Problems of Development and Violence**

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**Summary**

The paper lays out the framework for a new approach to problems of development. It emphasizes that all societies must solve the problem of violence. The framework distinguishes between two ways in which societies solve this problem. *Limited access orders*, covering most developing countries today, solve the problem of violence by granting political elites privileged control over parts of the economy, each getting some share of the rents. Since outbreaks of violence reduce the rents, elite factions have incentives to refrain from violence most of the time. Stability of the rents and thus of the social order requires limiting access and competition. In contrast, *open access orders*, which dominate the modern developed world, control the problem of violence through open access and competition. The framework has new implications for understanding development. It shows that transplanting institutions from open access orders into limited access orders – such as markets, elections, and corporate law – do not have their intended effect because the institutions work differently under limited access than open access. Because traditional development advice often threatens the logic of stability in limited access orders, these societies resist or sabotage it.

**I. The Problem of Economic and Political Development**

How can societies evolve to improve the conditions of their people? To address this problem, we need to understand the structure of economies and politics and the

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sources of change. By structure we mean that countries fall into different *social orders*, distinct patterns of organizing society that allow us to simultaneously understand the operation of political, economic, and other systems. In particular, this concept allows us to understand how society controls violence, the form of its institutions, the nature of its organizations, especially who can form them, and the dynamics of its economy. In all of human history, there have been only three social orders in our framework. Two of them concern us, the *limited access order* (LAO), which includes all large societies up to 1800 and most of them since, and the *open access order* (OAO), which includes around two dozen countries today.<sup>2</sup> To understand these social orders, we draw on the recent work of North, Wallis, and Weingast (2009).

Violence, real or potential, is a problem for all societies, but they address it in different ways. *Limited access orders* solve the problem of violence by using the political system to create and allocate rents, arising from arrangements such as government contracts, land rights, monopolies on business activities, and entry to restricted job markets. When individuals and groups with access to violence receive rents—ranging from extortion and corrupt payoffs to land rent, natural resource royalties, and monopoly profits—they have incentives to restrain the violence, because fighting reduces their rents. In contrast, *open access orders* solve the problem of violence through open access and competition. All citizens have the right to form contractual organizations, as long as they are not violent, and open access helps sustain both economic and political competition as well as an active civil society. In open access orders the state has a monopoly on violence.

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<sup>2</sup>The *foraging order*, reaching back in time before recorded history to the beginnings of human societies, will not concern us.

The framework of limited and open access orders provides a new way of understanding the development problem. Being *developed* means not only having high income levels but also accomplishing the transition from limited access to open access. It therefore requires fundamental changes in the way the economy and polity work. In addition to capital accumulation, being developed economically entails having sophisticated economic organizations and credible enforcement of property rights and other contractual commitments. Similarly, being developed politically entails having rule of law, a constitutional setting in which all major players accept changes of power, effective legal recognition of organizational rights independently of which party or ruler is in power, and state control of organized violence. Movement along these dimensions takes place in LAOs, but the permanent achievement of them has only occurred in OAOs.

Over the last two hundred years, development has been two separate processes. Since several millennia ago, the first development process has taken place within limited access orders, in which a less developed society improves economic performance and political stability, without the benefit of (or the ability to sustain) "developed" modern political and economic institutions. The second and newer development process occurs when a society makes the transition from limited to open access order, becoming what we consider a developed country— with an openly competitive polity and market economy — institutions that bring in their wake sustained capital accumulation and technological dynamism.

The framework implies that rising income, by itself, neither constitutes development of the second type nor is capable of inducing such development. Table 1 compares GDP per capita in a range of countries today with an historical timeline of

Britain and the United States. The table shows, for example, that Mexico today has the GDP per capita of the U.S. around the year 1950. But developing Mexico today still does not have OAO institutions like those of the developed U.S. of 1950 or Britain of 19xx, including firmly established rule of law, efficient contract enforcement, an openly competitive polity and economy, and a state monopoly on organized violence.

Table 1: GDP per capita across time and across countries

	2006 GDP	= USA in	=Britain in
United States	\$41,813	2006	--
United Kingdom	\$31,371	1996	2006
Mexico	\$11,387	1950	ca. 1965
Colombia	\$5,867	1931	
China			
Bolivia	\$3,715	ca. 1920	
Ghana	\$1,400	ca. 1880	1900

2006 real dollars, purchasing power parity.

Source: World Bank WDR, 2007. US Commerce Dept.

Rising incomes alone do not make Mexico, Colombia, Bolivia, China, or Ghana open access societies. Because of technological change originating in the developed world (OAOs), the world production possibility frontier has been moving out rapidly for the past two centuries, and limited access orders can grow in the sense of rising income per capita without making the transition to an open access order – without solving the second development problem. Although Brazil, China, and India have been developing in the sense of economic growth since the 1980s or longer, many developing countries are not even developing in this sense. The LAO framework does not predict that all countries will solve the first development problem, but it does help to identify some of the problems they face.

This framework has significant new implications for the problems of economic and political development. Policy prescriptions that work in the environment of open

access orders are unlikely to work, or may work perversely, in limited access orders. More importantly, attempts to implant institutions from open access orders – such as democracy, competitive markets, and corporate law – into limited access orders too often fail to achieve their goals because these institutions work differently in the context of limited access than in open access. Traditional development advice therefore fails because it does not account for the logic of limited access. These societies create limits on competition in order to solve the problem of violence. Attempts to transplant free markets into this environment may fail to achieve sustained economic growth and instead may undercut the rents that prevent violence. They therefore might make people worse off, not better off, and are therefore resisted.

This paper proceeds as follows. Section II discusses the logic of limited access orders. Section III turns to the topic of open access orders and the transition from LAO to OAO. Section IV points out several features of the modern world that affect development in limited access orders. Section V concludes with the main implications for development policy, including an analysis of why it frequently fails.

## ***II. Limited Access and control of Violence***

### **A. The Logic of Limited Access Orders**

Establishing a society that limits violence, fosters specialization, and exchange requires the creation of incentives for groups to compete peacefully rather than fight most of the time. Limited access orders (LAOs) are the natural response of societies to the threat of internal or external violence, and so North, Wallis, and Weingast (2009) call a limited access order a *natural state*. An LAO controls violence by forming a dominant coalition that includes the groups with potential for violence. Because rents of the elite are reduced when violence breaks out, it creates incentives for the elite to limit violence

and creates credibility when they commit to limit violence against each other. Sometimes they fight anyway, but the cost of fighting makes it less likely.

Maintenance of the rents depends on stability of the coalition, and vice versa. The creation and distribution of rents therefore motivates elite loyalty to the system, which in turn protects rents, limits violence, and prevents disorder most of the time. These causal links reflect the LAOs arrangements as a kind of social equilibrium: all the parts interact to sustain the social order. Rent-creation provides the glue that holds the coalition together, enabling elite groups to make credible commitments to one another to support the regime and to perform their functions.

An important feature of a limited access order is that it limits the ability of individuals to form organizations, in part because entry erodes the rents that hold the order together and in part because entry could enable opponents of the regime to organize and threaten it. While rents often result from the allotment of resources to particular groups and individuals, the control of organizations that perform specific social, political, or economic functions also generates rents and shapes the interests that hold the dominant coalition together.

Sophisticated organizations require the ability to make internal and external agreements that rely on enforcement by a third party. Such enforcement is often provided by the entity called the “state,” but not all LAO societies have a government that can or will do this. Part of developing a more sophisticated society is structuring a coalition whose members obtain support for their organizations. Some elite organizations are within the government, some outside, and the ability of the coalition to structure more durable arrangements for both public and private organizations is a central element in the first development problem. Support for organizations is limited to elites, which magnifies the rents they receive. Limiting access to perform functions, to utilize organizational forms and contracts that the coalition will enforce is the key to the limited access order: it creates rents through exclusive privileges and directly enhances the value of the privileges by making elites more productive through their organizations.

Although LAO societies do not inevitably adopt institutions that are good at supporting public and private organizations, as discussed in the next section, historically LAOs were a major innovation over the previous social order of hunter-gatherer

societies. The limited access order refers to a general strategy for organizing society, not a specific set of political, economic, or religious institutions. They allowed the formation of the great civilizations, with substantial specialization, exchange, and wealth. Some limited access orders of the past and the present have been more successful than others. Some have failed. The great civilizations of the past were all successful limited access orders. LAOs include the Roman republic and empire, Mesopotamia in the third millennia BCE, Britain under the Tudors, and modern Nigeria, Bolivia, and Russia. Some are vicious authoritarian regimes (Uganda under Idi Amin) while others have elections (Argentina); some are failed states (Zimbabwe) while others exhibit long-term stability (Mexico); still others have been socialist states (the former Soviet Union). All share the basic logic: manipulating the economy to produce rents, motivate stability, and reduce violence. Obviously these rents make the elite rich and powerful, as well as motivating the control of violence, but it is this latter function that most other frameworks overlook.

## **B. The Spectrum of Limited Access Social Orders.**

All low and middle income countries are limited access orders, yet they have income levels that differ by a factor of twenty. We distinguish three broad types of LAOs along a spectrum—fragile, basic, and mature—in order to help think about differentiation and the process of change within limited access orders. They are not distinct stages, but a continuum of societies differentiated by the structure of their organizations.

In the *fragile* LAO, the dominant coalition can barely maintain itself in the face of internal and external violence. Contemporary examples include Haiti, Iraq, Afghanistan, Somalia, and several other places in sub-Saharan Africa. Among the powerful individuals and organizations that make up the coalition, there may be a distinct organization called the “government”, but it has no monopoly on violence. Elite organizations are likely to be both public and private organizations, providing public and private goods, including coercion, in a fluid and constantly changing environment.

The bottom billion, described by Paul Collier, live in fragile LAOs (Collier 2007, 2009). In a fragile LAO, each faction in the dominant coalition has direct access to violence, and violence potential is the principal determinant of the distribution of rents and resources. If the allocation of these rent-flows is out of alignment with the balance of

power, factions demand or fight for more. Because of their instability, fragile LAOs have simple institutional structures for the government, and they cannot support private elite organizations. Individuals in fragile LAOs may perceive the potential benefits from better institutional structures, but the inability to maintain the coalition over long periods creates pervasive uncertainty about outcomes and prevents individuals and organizations from credibly committing to observe rules in many possible circumstances. Fragile LAOs attempt to create credible commitments among elites, but their fundamental instability means that the attempted commitments are not credible.

In the *basic LAO* range of societies, the government is well established compared to a fragile LAO. Establishment of a formal government organization (or more accurately, an array of government organizations) makes the state itself the main durable organization. Often there is also a significant religious organization. Elite privileges and organizations are closely identified with the state and government. Contemporary examples include Burma, Cuba, North Korea, Mexico at the height of PRI hegemony, and many Arab, former Soviet and Sub-Saharan African countries. In contrast to fragile LAOs, basic LAOs create and sustain a stable organizational structure for the state. Sanctioned organizations in the basic LAO are mostly elements of the state itself. For example, in twentieth century socialist countries, all organizations were embedded within the communist party or linked to it. As the state develops a more sophisticated internal institutional structure, it provides more organizational forms to citizens, but typically within the direct orbit of the state itself, including ruling parties. Basic LAOs do not support organizations outside the orbit of the state itself, even for elites, because any independent private organization potentially threatens the dominant coalition. As a result, all private elite organizations are closely and often personally tied to the state, even the branches of multinational companies operating in the country.

The specialization and division of labor within the basic LAO state derives from its ability to create organizations (such as ministries, public enterprises, and banks) to provide public and private goods for the dominant coalition, such as managing trade, education, religion, tax collection, or infrastructure provision. Violence potential in basic LAOs usually remains dispersed among state organizations, such as police, secret security and branches of the military, each with a way to extract rents through corruption



or monopolies. Although not every organization in a basic LAO has violence potential, those that survive have connections to some organization with violence potential; in case violence erupts, members of the elite know they will need protection.

In the range of societies that make up *mature LAOs*, the state supports a large variety of organizations outside the state, as well as within it, but still each sanctioned organization effectively needs to have some specific permit from the state. This allows the state to limit competition and create rents to maintain the dominant coalition. Mature LAOs include most of Latin America, China, South Africa, and India. Mature LAOs have durable institutional structures for the state and can support a wide range of elite organizations that exist apart from the state. A mature LAO, therefore, has a body of public law that specifies the offices and functions of the state, the relationship between the offices and functions, and provides for methods of resolving conflicts within the state, and by extension, within the dominant coalition. The law may be written or unwritten, but it must be embodied in a state organization, such as a court or bureaucracy, that is capable of articulating and enforcing the public law. The Chinese Communist Party, for instance, recognizes this need and is working on it.

In the mature LAO, unlike fragile and basic LAOs, some organizations come to specialize solely in political or economic activities. Violence specialists have more distinct organizations within the state, but they cannot be outside of the state structure and control. Mature LAOs cannot develop without sophisticated government organizations and without the parallel development of (non-violent) private organizations. Independent elite organizations are not only a source of economic development, but their presence also allows more sophisticated institutions and organizations to mature within the state. This is because the private organizations will act to protect their interests in the differentiation and autonomy of public institutions, such as courts and the central bank.<sup>3</sup> In a mature LAO, the government's commitments to policies and institutions can be more credible because elite private organizations are in a position to effectively punish the government if it deviates from its commitments.

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<sup>3</sup> The same process plays a more visible role in open access orders, where sophisticated private organizations in a market economy serve as a counterbalance to the government and other political organizations.

Mature LAOs are more resilient to shocks than fragile or basic LAOs. The durable public institutions of a mature LAO are capable, in normal circumstances, of lasting through changes in the make-up of the dominant coalition. Nonetheless, strong shocks always have the possibility to cause breakdowns, and mature LAOs do face intermittent crises. The extent to which mature LAOs have more durable state institutions than basic ones is a matter of degree rather than of kind.

Table 2 summarizes the spectrum of LAOs described above. Although the types can be ordered in a progression from less to most developed, we do not see the progression as a teleology; societies do not inevitably move from fragile to basic or from basic to mature. Societies regress as well as progress, and many societies stay as one type for decades or centuries. Some exhibit a mix of types—Colombia appears mature in Bogota and Medellin but fragile in many rural departments. Ecuador, Venezuela, and Russia seem to be regressing as they nationalize or outlaw once independent organizations. Similarly, societies that fall into violence, such as Rwanda, Somalia and the former Yugoslavia, all regress. Germany in the 1920s and 30s regressed from being a mature LAO on the doorstep of OAO in 1913 to become a basic LAO under the Nazis.

**Table 2: Types of Limited and Open Access Orders**

<b>Type (Examples)</b>	<b>Economic Organizations (EOs)</b>	<b>Political Organizations (POs)</b>	<b>Violence Potential (VP)</b>
<b>Fragile LAO</b> (Afghanistan, DR Congo, Haiti)	EOs and POs are not clearly distinguishable, except perhaps for multi-national firms present in fragile LAOs.		All organizations have VP. Civilian and military not clearly distinguished.
<b>Basic LAO</b> (USSR, Saudi Arabia, Tanzania 1970-90s, Mexico 1940s-80s)	All EOs—public or “private”—are linked with the central state; some are also linked with multi-nationals.	Most POs are controlled by the state, eg. one-party state or dictatorship. Opposition parties are under threat.	Most VP organizations are part of state, yet perhaps competing or threatening the civilian state.
<b>Mature LAO</b> (Mexico since 1990s, Brazil, South Africa, India, China)	Many private firms, some multi-nationals. Effectively limited entry, requiring political connections.	Multiple POs, but dependent on central permission. Democratic process, if present, cannot challenge major economic powers.	State controls almost all VP.
<b>OAO</b>	Most are private.	Non-discriminatory	No non-state

(Western Europe, USA, Canada, Japan)	Non-discriminatory rules for any citizen to start an EO and get state legal support..	entry rules for any citizens to start or join a PO.	organizations have VP.
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### C. Development within LAOs

LAOs are dynamic, not static. They often progress across the types of LAO, because the progression increases rents, and elites can make themselves better off if they manage to retain power while moving from a fragile to a basic LAO or a basic to a mature LAO. But many LAOs stagnate or even regress. The reason is that all LAOs are vulnerable to internal shocks and to changes in the environment – relative prices, technology, demographics—that affect the relative power of elites. As relative power shifts, those gaining power will naturally demand more rents. If all agree on how power has shifted, bargaining should adjust rents. But when elites in an LAO disagree about relative power shifts, they may draw on their violence potential and end up fighting, particularly if some elites believe they are stronger than others believe they are. Thus, LAOs often regress into various forms of disorder. In short, LAOs are not static, but rather they evolve while remaining LAOs.

Although most LAOs have not become OAOs, some but not all do become more mature— achieving status as “emerging market economies” and so on. These are important advancements and are the basis for most of the recent reduction of world poverty. Three processes seem to be key for the maturation of an LAO:

1. ***Bringing all (or at least more) of the organizations with violence potential into relationships that give them incentives to minimize actual violence.*** This does not necessarily involve bringing all of them under the direct control of the state (in the Weberian sense of a state monopoly on violence), although this is part of the maturation process in an LAO reaching the doorstep of transition to OAO (described below). Completed consolidation of violence means that only specialized organizations (military and police) may use violence, and that they are controlled by the state and follow explicit rules about the use of violence against citizens.
2. ***Increasing the scope of relationships in which rule of law is effectively maintained.*** Expansion of the rule of law will only be sustainable when it is consistent with the

arrangements that generate adequate incentives to restrain violence, and some rule of law seems to be effective even when its scope is limited. It can be late in the maturation process when the rule of law covers all public relationships among elites, and even later when rule of law is effective for the wider population.

3. ***Increasing the reliability across time with which the state provides support for the organizations and enforces agreements among them.*** Strengthening organizations that make up the state—executive, legislative, military, police, main parties, public sector unions—depends in part on strengthening organizations outside the state—private firms, opposition parties. The organizations of the state achieve more coherence and credibility over time when organizations independent of the state achieve enough strength and coherence to hold the state accountable for its commitments, independently of the individuals who initially made the commitments.

The changes that make an LAO more mature are not sufficient to bring about a transition into an OAO, but they have always been part of the story for countries that became OAOs. Completing these reforms are what we call the ***Doorstep Conditions*** for the transition: (1) centralized and consolidated control of violence; (2) rule of law for elites; and (3) support for perpetually lived elite organizations outside the state. In other words, these reforms seem to be necessary but not sufficient for a transition, and even without a transition to being an OAO, such reforms improve the economic performance of an LAO.

### **III. The Logic of Open Access Orders**

To understand LAOs, we must also look at open access orders (OAOs), not only as a contrast but also as a dominant part of the world context today. OAOs are sustained by institutions that support open access and competition: political competition to maintain open access in the economy and economic competition to maintain open access in the polity. In OAOs, control over organized violence is consolidated in military and police forces; other organizations are not allowed to use violence. The political system controls the organizations—military and police—that have a monopoly on the legitimate use of violence.

An open access order requires that the interests of economic, political and social groups can organize, reorganize, and reformulate themselves to defend their interests in response to government policies and to pressure for change. In the presence of appropriate constitutional institutions, strong private organizations help to check the use of military and police force by the government.

Open access is sustainable in societies where: 1) entry into economic, political, religious, and educational activities is open to all citizens as long as they meet standard (impersonal) requirements; 2) the state supports organizational forms in these activity areas that are open to all citizens; 3) rule of law is enforced impartially for all citizens; and 4) the state has a monopoly on violence, potential and actual. The portion of the population enjoying open access need not be 100 percent in order to sustain open entry in economic and political systems, which points to the importance of defining citizens.

Schumpeterian creative destruction plays a central role in OAOs, as entry into economic activities is open to all citizens and potential entrepreneurs get state support for organizational forms like partnerships, corporations, and contract law. When entry is open, economic actors create rents through innovation. Competition erodes those rents in unpredictable ways, as firms and individuals enter into new lines of business or transform old activities.

Economic actors typically want to use the political process to restrict entry and maintain their rents. Similarly, political actors would like to use the political process to restrict entry, create rents, and bind economic actors to support their political coalition. That, of course, is the logic of the LAO. In an OAO, however, the state and the larger society do not control the distribution and content of economic interests, which are constantly and unpredictably changing. So the political system cannot effectively manipulate economic interests to order its internal arrangements. Open access orders maintain their equilibrium by allowing a wide and constantly shifting range of economic and social interests to compete for control of the polity.

The *transition* from limited to open access orders has two key features. First, within LAOs it is possible, following the logic of the LAO, for a mature LAO to develop institutional arrangements that enable impersonal exchange among elites. Second, the

transition process begins when the dominant coalition finds it in the interest of elites to expand impersonal exchange and, therefore, incrementally increase access.

Historically, societies that developed sustainable property rights and rule of law began by making credible commitments to sustain those rights for elites. Once elite rights were defined impersonally, then it became possible to extend those rights to wider circles of society. Defining and enforcing legal rights occurred as societies developed sophisticated public and private elite organizations (i.e., becoming mature LAOs) and increased the range of credible commitments the state could make.

In the maturation and transition of LAOs historically, some areas of the economy and polity became more open through the extension of impersonal forms, while access in the commanding heights remained dominated by limited access arrangements. The tipping point came when open access in one dimension – economic or political – achieved sufficient power to press successfully for open access to the commanding heights in the other dimension. For example, in the U.S., open access on the political side had progressed by the 1830s to the point of bringing universal white male suffrage in most states and bringing Jacksonian Democrats to the national presidency. Then when the economic crisis of the 1840s came, the states of the North, which controlled access to the economic commanding heights (banks and transport companies), established open access economic institutions, such as general incorporation laws (Wallis 2006). Many features of open access were present in the U.S. earlier, and many features of limited access persisted -- notably in the South for another century -- but the tipping point came when opening access on the political side reached high enough to push through effective open access rules for the top of the economy. By contrast Germany in 1913 had all the doorstep conditions for transition to OAO, but it did not cross the threshold because the upper echelons of the economic and political systems remained limited to a small elite.

When the tipping point comes, the dominant coalition finds that its interests are better served by supporting intra-elite competition, rather than intra-elite collusion to perpetuate existing mechanisms of rent-creation. At this point in the transition, rapid and fundamental changes institutionalize “open access within the elite.” This sounds paradoxical, but remember that an open access order does not require universal open access. Once, however, the elite has created political, economic, legal, and social

institutions that define elites as citizens and all citizens as equally and impersonally guaranteed to rights and privileges under the social arrangements, it becomes possible to extend citizenship and access to larger segments of society.

In summary, a transition has two parts in the historical cases that we examined. The first part occurs when a mature LAO achieves the doorstep conditions, listed earlier. There is nothing, unfortunately, about being on the doorstep that impels societies into a transition. The doorstep conditions create the possibility for intra-elite impersonal exchange. The second part of the transition occurs when intra-elite relationships are put on the impersonal basis of “citizenship”: when each elite possesses his or her rights simply because they meet certain impersonally defined requirements. Further research is needed to see if transitions since 1950 show similar features.

#### **IV. The Modern World and its Effects on Limited Access Orders**

The world today differs substantially from that of 1800, in large part because OAOs have grown and controlled large parts of the planet for the last two centuries. In light of the logic of the limited access order, we examine four dimensions of the effects of the developed on the developing world – the availability of institutional forms in open access orders, multinational firms, technology, and the world political order. The practitioners and academics in development community have often hoped that these new factors in the modern world will make it easier for limited access orders to develop and become OAOs, but often this has not happened.

*Institutions.* Extensive experimentation with political and economic institutional forms has occurred in the past 200 years – constitutions for presidential and parliamentary systems, federal and unitary states, different types of socialist systems, and various forms of limited liability companies and financial institutions. The literatures in law, political science, and economics describe the outcomes associated with these institutional forms. Decision-makers in developing countries – established elites or newly empowered leaders of the revolution or the former opposition– can and do look at this annotated menu when they consider changes in their systems.

Do these menus allow faster maturation in LAOs and easier transitions from a LAO to an open access order? In a few places, like Europe, the answer seems to be yes,

but in many regions the effect is unclear. When the first movers began institutionalizing open access for elites after 1800, those societies had no idea that they were creating an open access order and fundamentally changing the structure of their societies. There was no way they could know; there had never been an open access society. In contrast, the institutional forms of an open access order are well-known today, and elites in LAOs can choose which institutional forms to bring in. Many elites in LAOs have been educated in the OAOs of Europe and North America and bring back ideals of the institutional models from where they have studied or from former colonial metropolises. Often they hope for quick transitions at home, but find that implementing OAO institutions is much more difficult than the latest production technology.

Even well-understood institutions, however, such as joint-stock corporations and proportional representation parliaments, operate differently when the surrounding economic and cultural situations are different, as in LAOs. Directly transferring the institutional forms and mechanisms of open access orders to LAOs does not produce development – even if the LAO leaders adopt the institutions with good will and good intentions. Many developing countries today have most of the formal institutions associated with OAOs – legislatures, formal executives, courts, bureaucracies and elections – but these institutions nonetheless sustain limited access rather than open access. Access to welfare programs, business licenses, and judicial services, typically require personal connections and often bribes. Ration cards in India, for example, often never reach the poor; instead they are sold informally to people who can afford them, generating income for those who distribute these cards. In LAOs, elections are more a means of political control than a vehicle for citizen choice. Political officials in these states can short-circuit electoral competition by making basic services such as water, electricity, and garbage depend on whom citizens vote for. The logic is at once tragic and brilliant—for example, in the PRI era most Mexicans voted for the incumbents, despite preferring the opposition, because they wanted to maintain their services and saw no hope for a regime change (Diaz, Magaloni, and Weingast 2006).

Whereas limitations on access were often formal in earlier LAOs, such as European feudalism or imperial China, many limitations in LAOs today are informal. Indeed, the informal limitations on access often determine who can effectively utilize the



formal institutions associated with open access in the developed countries -- political parties, legalized property rights and corporate organization. Only the elites have full access to them, thanks to personal connections. So, even though the law *de jure* supports impersonal exchange, the weak enforcement of laws means that *de facto* exchange remains impersonal. Even if formal limits on access are not imposed by the elite, informal barriers (which do not much bind elites) are tolerated and perhaps encouraged, as elites benefit from the limits to competition.

**Multinational Corporations.** Private firms from OAO countries have a strong presence in almost all LAOs today. These organizations make manifest the most important economic institutional forms of the OAO world order, and thus potentially smooth the way to form similar organizations in LAOs. Most firms from OAOs operating in today's LAOs rely on personnel connections or on the institutions of the international open access order to support their contracts and therefore do not need to rely on the LAO's institutions to maintain themselves. That is, multinational organizations rely much less on the third party enforcement and support of the host country; instead, they bring it with them. This gives multinational firms significant advantages over domestic firms in an LAO. In today's LAOs the private sector development programs of the international financial institutions and donors typically emphasize the formal steps of creating OAO institutional forms, but the results are frequently disappointing because they do not address the fundamental incentives to restrain access.

As described in North, Wallis, and Weingast (2009), the institutions of modern private firms emerged over the last 400 years in today's OAOs (especially the first movers, the Britain, France and the Netherlands), when the elites had a material interest to have such organizations in order to expand the scope and profitability of their operations. To meet their needs, elites in LAOs (who did not know they would become OAOs) had to develop domestic institutions to support these organizations, which later became accessible to wider circles of society. In LAOs today the elites have other options to create viable organizations, such as alliances or joint venture with a multinational firm. They can also invest their assets through a multinational firm, such as a bank or investment company in London, Tokyo, Zurich, New York or Miami rather than relying on domestic instruments of investment (Global Witness 2009; Root 2009).

This institutional retardation may inhibit not only achievement of the doorstep conditions and an eventual transition to OAO, but also the maturation of the basic LAO. The ability of LAO elites to rely on multinational firms for profitable interaction with the global system lessens their incentive to improve domestically established organizations and even the organization of the government itself. Thus rulers of Equatorial Guinea and Mobutu's Congo (Zaire) could sell oil and other minerals to the world and have the profits sent to their personal bank accounts in the US or Europe; they have what they want without even getting a functioning ministry of finance, much less a domestic private financial sector.

The result is that many LAOs today have dualistic economies, with a domestic economy governed by LAO rules and international enclaves run by a separate set of rules and institutions, modeled on and enforced by foreign OAOs. Other observers have remarked on the duality in terms of production efficiency and incomes; our analysis highlights the duality in access to security for contracts and organizations, which underlies the other dualities. Even in places that are quite lawless in some ways, international firms and their local partners enjoy relatively good protection of their contracts.

Observers and advisors from OAOs wonder why the duality persists. The logic of the LAO suggests that participation in the enclave of the global economy, with access to international capital and secure property rights, particularly when access to the enclave is limited, is a source of rents that can be manipulated by to sustain the political regime. By allowing additional streams of rents without threatening the domestic order, enclaves allow elites greater rents and thus greater incentives to maintain the LAO system. Because of their international connections, local elites in limited access orders today have less incentive to create better local institutions (outside the enclave). This tendency is reinforced because the weakness of local institutions creates a barrier to entry that benefits incumbent elites.

**Technology.** Compared with 200 years ago, technology is the most eye-catching difference in the world today, both in the level and in the rapidity of change (Landes 1969, 1998; Mokyr 1990). Technology transfer has the promise of letting more

backward economies catch-up quickly in GDP per capita. Unfortunately, on the institutional dimensions that are the crux of development in our framework, internationally available technology has mixed effects. Elites in LAOs can adopt technology in a selective way, without needing to enable the organizational maturity required for home-grown technology development (c.f. Acemoglu and Robinson 2006).

This point does not deny the productivity benefits to the elite in a country that has its own technology development; rather it recognizes that there is a cost to having the open access necessary for local technological progress – a cost not only in money but also (from the point of view of an LAO elite) in loosening the control on access to organizational forms. If elites can get most of the technology they want without allowing a flowering of potentially competing organizations, then they are less likely to allow such institutional change, which could threaten their situation.

Also, two centuries of change in the technology of weaponry and communications—essential for forming and maintaining organizations—have altered the way that LAOs operate. Think of the AK47, the cell phone, and the internet. These topics warrant further research.

**The World Political Order.** The world political order has changed fundamentally since 1800; including in the way that governments define themselves, their population, and their territory. Until the latter half for the 20<sup>th</sup> century, the survival of a country depended on the ability of its elites to maintain enough internal order and economic strength to be able to defend its borders. Since the 1950s, however, the United Nations and other multilateral institutions (including World Bank and IMF) and rules of Cold War competition effectively guaranteed the external borders and provided access to emergency aid to any UN member. Some of these national states have developed institutions to maintain internal order and external autonomy, while others drifted in and out of failed status. By contrast, in the world order of 1800 and before, any failed state was taken over by powerful neighbors (Tilly 1990). International policing of borders generates a paradox: a society ruled by a “failed state.” A failed state lacks a coalition that dominates within the externally imposed boundaries. In places like Afghanistan, Iraq

and Somalia, the ongoing inability of powerful groups to form a coalition, even if fragile, perpetuates violence and civil war (Bates 2000, Collier 2009).

Elites in failed or miserably performing states today can stay in power with financing from various combinations of foreign military and economic assistance and sales of natural resources – Bolivia, Venezuela, Surinam, Guyana, Nigeria, Zambia, Pakistan, and so on. Even states that fail to control major parts of their nominal territory, such as Congo, Somalia and Sudan, still obtain international backing and subsidies to maintain the guise of a national state. Thus, states now face weaker negative sanctions that would pressure their elites to develop institutions to make their domestic economies strong (Bates 2000). Only a few places on the front line of the cold war – like Finland, South Korea, Taiwan, and West Germany– faced such pressures since the mid twentieth century, and this may have facilitated their transitions toward open access. These places also needed an army to deal with external threats, and this in turn required an economy sufficient to support the army. In Latin American and African countries, by contrast, the military has played primarily a domestic role, supporting the ruling coalition in maintaining limited access. The change in the external environment seems to have made achievement of the third doorstep condition – centralized civilian control of the violence – more difficult. More research is needed to understand why.

#### ***V. Implications for Development Policy and Assistance***

As seen through the LAO lens, developing countries face two separate development problems, as mentioned before, and the policies necessary to foster development are different for each problem. The first development problem, the movement along the spectrum of LAOs – fragile, basic, mature – and the creation of the doorstep conditions, is more relevant for most recipients of development assistance, especially the poorest, most fragile, and most prone to violence. Improving as an LAO has great potential to raise incomes and reduce poverty, as we have seen recently in Chile, China, Brazil, Mexico and India.

Making progress under the first development problem requires fostering reform of institutions as well as policies in situationally appropriate ways. Rodrik and co-authors have used the concept of binding constraints to advance our thinking about how to tailor

economic policy to the actual situation of developing countries, which is usually too far from the first best for that to be the model (e.g. Hausman, Rodrik, and V 2008).. Our framework can complement that by shedding light on how the binding constraints are not just errors but are often integral parts of the limited access order.

The relevant agenda of institutional reform in an LAO depends on its starting point. In states with high active violence, reducing it is an essential step and may require rent-sharing deals with unsavory elites, like war-lords in Afghanistan. Failing states cannot simply turn themselves into OAOs. Our framework implies that creating peace in violence-torn societies involves creating a basic LAO, not in creating an open access order with democracy and markets, nice as that may be for a long term goal. Fragile LAOs thus need to concentrate on steps to help the state solidify itself and gain more state control through bargains that contain violence. Basic LAOs need to mature by fostering private firms and non-state organizations, usually still dominated by elites, and by establishing rule of law within the state, such as following rules for presidential succession and party leadership. Mature LAOs should focus on creating the doorstep conditions, like improving the legal framework for independent private non-state organizations. Because LAOs are elite-controlled, many of the reforms will have the immediate effect of helping elites increase their rents, with later and secondary effects of improving the lives in wider circles of society (cf. Kuznets, 1971 for predicting a similar phenomenon based on capital accumulation).

In the last fifty years, donor organizations have provided developing countries (and failed states) with policy advice, technical assistance, and money. The recommendations from the standard approach to development aim to introduce elements of open access orders into developing societies— property rights, competitive markets, institutions of the rule of law, and competitive democracy. Such policies often fail when inserted into limited access orders because the advice does not take account of the problem of the endemic distribution of violence potential. Some of standard policies can work in LAOs, indeed they may help the movement toward a more mature LAO and the achievement of the doorstep conditions, but our model predicts that policy reforms will yield the expected benefits only if consistent with the logic of limited access in the country's actual circumstance.

Reforms risk failure and institutional regression if they depend on a open access notion of the state having a monopoly on violence and using it to deter all violence by others. Except in the most mature ones, LAOs do not deter violence through the **state's** ability project violence. Indeed, LAOs where the government possesses a true monopoly on violence are likely to be tyrannies, such as Nazi Germany and the former Soviet Union. Allowing order to breakdown does not lead to a fresh start where open access institutions can flower, but rather it strengthens the appeal of using limited access to restore order, as when Latinos in the past looked to a strong man to restore order. More competition, open access, and freer markets can help some countries, but in others these measures weaken the rent-creation system that holds a LAO together; they therefore risk increasing violence and making a reversion back to being a fragile LAO. Similarly, attempts to remove corruption, create impersonal rule of law, and institute competitive electoral democracy can destabilize a mature LAO and generate broad resistance. Of course, groups who benefit directly from market distortions – firms that receive monopoly profits or groups that receive services at subsidized prices – will resist the reforms. Paradoxically, many who are exploited by these policies may also hesitate to support the reforms that threaten the LAO because they see disorder and violence as worse than being exploited economically.

Another problem is the possibility that the dominant coalition in a LAO may adopt the institutions proposed by an international donor without fundamentally changing the way the society operates. Since institutions and mechanisms operate differently in different societies, recipient countries often adopt the recommended institutional forms and then co-opt those forms to sustain or strengthen their LAOs. In retrospect, donors evaluate these programs and complain that the reforms were mere window dressing or that the country lacked “political will.” To get a more useful diagnosis, it would help to look through the LAO lens to understand how elites have incentives to subvert these reforms or, as they would see it, to adapt the institutional forms to local conditions.

Our approach does address the problem of poverty in that mature LAOs are significantly richer than fragile LAOs, and the ratio of income differentials is much wider among LAOs—from \$400 to \$8000 per capita—than between OAOs and the middle-income LAOs. Moving developing countries along the progression of types of LAOs

typically expands the middle class and at least some LAOs have thus made significant progress in reducing poverty (Dollar 2005). Moving states along the LAO progression yields benefits for the poor, as these states become more resilient to shocks and therefore suffer fewer debilitating crises that hurt everyone in the society.

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Endnotes