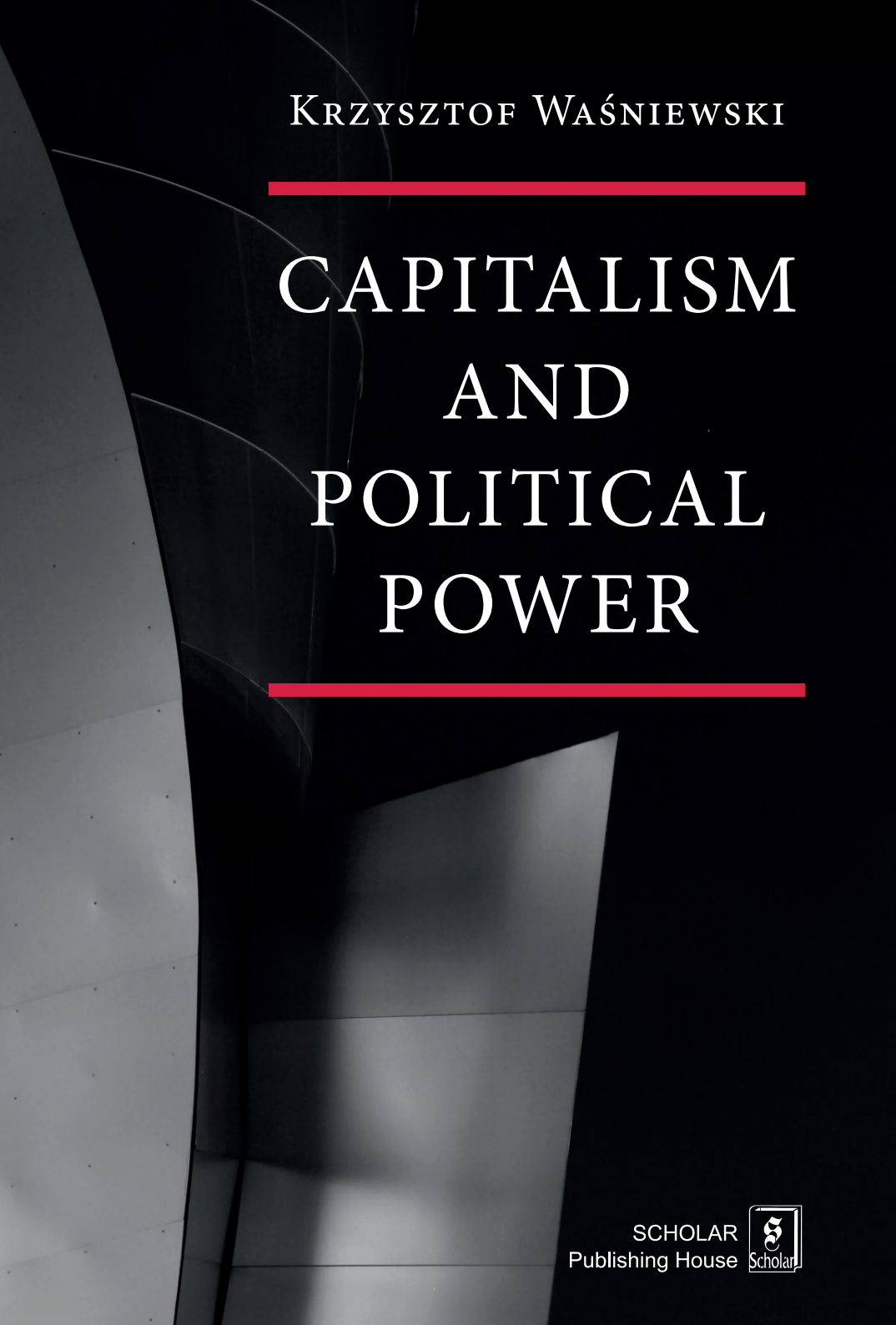

Krzysztof Waśniewski

CAPITALISM AND POLITICAL POWER

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Introduction

The content of this book covers nearly four years of research on fiscal policy, and more exactly on one central finding: the government's fiscal stance is strongly correlated with the political system in place. In other words, similar macroeconomic conditions, experienced in different political systems, produce clearly different fiscal outcomes. That pattern is particularly well visible when the political system is studied in terms of the number of distinct players in that system, and when the fiscal stance of the government is comprehended as aggregates rather than flows. Expressed simply, this correlation indicates that the more distinct players there are in the political system, the more liquid financial assets are retained in the public sector.

This basic correlation prompts an investigation of its underlying mechanism, namely the way in which the public sector can retain capital, as well as the outcomes of such retention. In other words, we look at the connection between capitalism and political power. Probably one of the most striking features of modern capitalism is a growing accumulation of fixed assets in the global economy, accompanied by a decreasing velocity of money. Capital in the global economy displays a growing tendency to coagulate rather than to flow. At the junction of capitalism and political systems, another trend is visible: after reaching a peak in the 1970s and 1980s, the share of public expenditures in the fixed capital stock, on the global scale, is systematically decreasing. Political systems, at least at the level of their officially disclosed fiscal flows, seem to be withdrawing from capitalistic processes. Going one step further, we delve into the political systems proper, which also display, on the global scale, quite a coherent tendency towards standardization on the basis of a few known constitutional patterns or, to simplify, through reducing the number of political players.

As this book was being written and reviewed, an important contribution was made to the topic with the World Bank publication of its

World Development Report 2017 under the specific heading *Governance and The Law* (World Bank 2017). The report essentially confirmed the intuitions developed in the first manuscript of this book: whilst political systems across the globe seem to increasingly converge towards some typical patterns of public governance, the actual efficiency of those systems in delivering essential outcomes expected from constitutional states – security, growth and equity – decreases. The main theses developed in the *World Development Report 2017*, as well as the critical remarks from Professor Jerzy Owsiak from the Cracow University of Economics, inspired the author to change the structure of this book, from the initial, broadly essayistic convention, into a more disciplined and focused one. Focus means, first of all, identifying the ultimate goal of writing this book and explaining clearly why it is important. **Thus, the purpose of the present book is to explore and possibly verify the central hypothesis: when considered as a technology, constitutional states seem to be losing their efficiency as well as their capacity to control capital, whilst standardizing their structure and giving up experimentation.**

To that end, three fundamental, theoretical steps are developed. The first one elaborates the general assumption that constitutional states and political systems in general, can be grasped as functional technologies. This is a phenomenological assumption, i.e. it pertains to our own, human cognitive processes rather than to the ontological essence of societies. Émile Durkheim, one of the founding fathers of sociology, used to claim that we, human beings, always live in social structures and there is no systematic evidence of humans living strictly on their own, without any socialization. Still, we live in many social structures in parallel, and political systems are just a fraction of that complex structural pattern. Following in the footsteps of the French historical school, and Fernand Braudel in particular, this first chapter of the book explores the fact that constitutional state, as a type of social structure, has a lifecycle clearly linked to the function of resources and population. The main theories of society and politics are mentioned in review in order to show the different angles of approach to that issue. At the end of the first chapter, a tentative empirical insight is developed, with an intuitive focus on three categories of phenomena: migrations, changes in international law and structural properties of national political systems.

In conclusion of the first chapter, a pivotal idea is outlined, namely that of political power seen as a compound resting on two pillars: popular legitimation and economic power. The latter expresses itself

in the capacity of the body politic to appropriate capital. This general conclusion is further developed in the second chapter of the book, devoted to the fiscal function of constitutional states. An empirical observation is fundamental at that point, namely that most governments both display a gross indebtedness and hold a certain amount of liquid financial assets that can potentially be deducted from gross debt. From there, the book focuses on the main body of empirical evidence, i.e. economic aggregates that allow estimating the extent of capital appropriation in the political system, namely quantitative analysis of fiscal stances in the governments of 77 countries selected according to the official disclosure of net public debt. The latter, when subtracted from gross debt, allows calculating the amount of liquid financial assets held by the public sector. That latter aggregate displays interesting patterns of distribution in space and time. Particular categories of political systems, defined according to electoral regimes and to the balance of power between the parliament and the president, display clear, systematic differences as to the amount of financial assets held by governments. The same amount of financial assets makes probably the most noticeable fiscal trend in the whole sample: constitutional states seem to hold, in the form of liquid financial assets, a systematically shrinking part of their gross domestic product. Another trend, namely that of gross public expenditures expressed as a percentage of domestic, fixed capital stock, displays a descending tendency as well.

The tentative conclusion of the second chapter is that presently we are witnessing a relative withdrawal of constitutional states, as functional technologies, from capitalistic processes going on in the global economy. The third and last chapter of the book follows in that path and sketches a portrait of global capitalism. The sketching starts with the assumption well known for centuries, expressed by Adam Smith, that business adapts to the natural environment of men. Presently, as a species, we are facing dire environmental challenges as we have reached a historical record in terms of the population – a Malthusian check looms on the horizon on the global scale. Against that background, one theoretical assumption formed by the Club of Rome is developed further, namely that efficient management of environmental challenges requires controlling the accumulation of productive capital assets. Empirical data shows that at the global scale, the same accumulation in fixed assets is advancing at a pace far from that recommended by the Club of Rome. We are heading against a brick wall, as it seems and yet, the picture is even more complicated: the intense, global accumulation of physical capital is accompanied

by a systematically decreasing velocity of money in the global financial markets. Following the intuition of Paul Samuelson, it can be assumed that money is a technology, just as political systems are. A fascinating correlation appears: as constitutional states seem to be losing control over capitalistic accumulation, the banking system seems to be losing efficiency in settling liquid capital balances on the global scale. Our social technologies are clearly changing: one technological generation of social structures, based on the aggregation of capital in big, national communities (constitutional states) and on the financial securitization of contractual obligations (money), seems to be progressively fading. The big question, signalled in the final conclusion of the book, is about the future possible structures that could help humanity to grow and prosper.

This book would not have been structured into its present form without the sobering, matter-of-fact remarks formulated by the reviewer, Professor Jerzy Owsiak from the Cracow University of Economics, Poland. The author wishes to express his deep gratitude to Professor Owsiak for his patient reading and pertinent insights.

Chapter 1

The constitutional state as a functional technology

In the introduction, a strong claim has been formulated: constitutional states and political systems can be considered as technologies, thus in strictly functional terms. The claim deserves development, which, in turn, requires reviewing the theoretical foundations of social sciences. Constitutional states are social structures: this statement is plain to anyone familiar, even remotely, with social sciences. The deeper implications are both less obvious and truly important. Physicists say: structure determines function, and function determines structure. Applied to social life it means a loop: we live in social structures; those structures determine the way we live and the way we live determines the structures we make to live in. As challenges come, and as we need to change the way we live, we also need to change the structures we live in. The necessary ingredient for changing anything practical is to experiment with new solutions. The loop between structures and everyday life puts us more or less inside the experiment we are supposed to conduct. We are in the position of that 19th century inventor for whom the only way to experiment with a new engine was to turn it on, stand by and hope the whole contrivance would not explode right in his face.

Understanding the structure that we are experimenting with is crucial to survive the experiment and possibly come up with something new and interesting. Thus, the first logical step in predicting the possible future changes of our societies is to understand the social structures we live in. The emphasis is on understanding as such rather than on some precise structures. No matter what type of social structures we are talking about, it is always a narrative about some kind of reality so complex that

our language is barely sufficient to scratch the surface. The language itself is also a social structure, as we think about it. Returning to the metaphor of the 19th century inventor, understanding social change is very much like attempting to open a locked box with the key which is to be found inside the box. The obvious solution is to drill or cut a hole in the box, reach inside and get the key, and then, finally, open the box with all the ceremonies required. This is very much the ambition of the present chapter: to make a hole in the box made with our structured understanding of the structures we live in. In other words, presenting multiple points of view on social structures and their formation is important for understanding the way we come up with such points of view. The selection of theories introduced in the present chapter is highly subjective and, although obviously limited by the personal views of the author, it still follows a basic logic. We often think about our own social life from two fundamentally distinct perspectives, which may be designated as, respectively, the moral one and the determinist one. The moral perspective rests on the central assumption that society is what we want it to be; it is the outcome of our conscious decisions and actions and the role of the constitutional state is, at the bottom line, what we want it to be. Social activists who occupied Wall Street deeply believed their actions would make a difference. Seen from the determinist point of view, their actions were an organic reaction to the cognitive dissonance caused by the shortage of valuable resources. From the determinist perspective, our current social order reflects temporary adaptation to the changing natural conditions. Institutions of the constitutional state are one of many attempts at achieving successful adaptation. Between those two extreme views, many intermediary philosophies exist. Economic sciences postulate a mix of the two, approached from the point of view of objectively observable and mathematically measureable relations between phenomena, e.g. the relation between demographic growth and urbanization. The evolutionary philosophy transplants the Darwinian theory of evolution onto the grounds of social sciences and builds multi-level explanations of social behaviour, starting from the most proximate reasons and moving towards the ultimate ones.

One of the central assumptions developed in the present book is that we, i.e. humanity, have collective intelligence that manifests itself as the capacity to learn through interaction. When two companies operate different technologies on the same market, different economic outcomes will follow. One of these technologies will emerge as more efficient that

the other ones, and probably will become the solution of choice for future entrepreneurs, whereas the least efficient one will be forlorn, or transformed and relaunched. Whatever the outcome, the fact of interaction between multiple entities in the same environment leads to learning, which, in turn, leads to a modification in the patterns of behaviour. When two social structures, a constitutional state and a corporation, run parallel operations in the field of new energy sources, they will come up with different results. With time, one of these structures will prove definitely more efficient that the other. The efficient solution is likely to be copied, whilst the advocates of the inefficient one will have to introduce modifications in their approach. In any case, the sole fact of different entities interacting in the same environment leads to their patterns of behaviour being changed. New patterns create a new environment and possibly new entities, and so the mechanism works. That assumption of collective intelligence is a hermeneutic presumption of any social theory, i.e. social theories emerge and spread as temporary attempts to make sense of social changes that we experience, and social scientists are the accounting clerks of the society. They try to tailor a rational outfit to events that societies frequently see as "historical fatality", etc. Such a view of social structures is close to the evolutionary theory, albeit less ambitious. Evolutionary social sciences, e.g. evolutionary economics, tend to distinguish proximate explanations from ultimate ones. The proximate explanation of a phenomenon is basically another observable phenomenon or a set of phenomena that we can functionally correlate with the phenomenon being explained. In that respect, changes in prices are correlated with changes in the amounts being traded. Ultimate explanations refer to some kind of final purpose, or overarching function, ascribable to a given phenomenon. Thus, changes in prices, as correlated with changes in the amounts traded, can be viewed as the fulfilment of a general purpose, namely that of economic efficiency. The assumption of collective intelligence, expressed in this book, does not go as far as to attribute ultimate purposes to collective learning. This "evolutionary agnosticism" has both empirical and theoretical presumptions. As one observes the actual social changes, circularity is frequent. Returning to the "price-quantity" frame of thinking, the so-called "pork cycle" is a good example. The expression designates a phenomenon well known in agricultural economics: when the prices of pork meat go up, farmers expand their livestock. Expansion of livestock leads, after the new animals reach the age at which they are slaughtered and consumed, to an increase in supply. Greater supply

of pork leads to a decrease in prices, which, in turn, creates an incentive to reduce the number of pigs. A smaller livestock population leads to lower supply and higher prices, which again induces farmers to expand their livestock, etc. Whilst the phenomenon is colloquially dubbed "the pork cycle", it refers to any field of agriculture where producers can more or less flexibly adapt the volume of production to changing prices. We have here a complex cycle of social changes in the farming business revolving around the natural cycle of growth in animals or plants. Interestingly, the shorter that natural cycle (i.e. the shorter the time required to efficiently adapt to the changing prices), the more likely the economic cycle is to occur. In some fields of agriculture, though, where the natural cycle of growth is somehow too long, the "pork cycle" is not really observable. Production of wine and the cultivation of vineyards is a good example. Grapes grown for wine need many years before they reach sufficient maturity, and a lot of costly experimentation is required before the vineyard starts to yield a predictable taste. Even if prices fall, producers would rather stockpile their wine than reduce the acreage of vineyards. A biological cycle that is too long makes the "pork cycle" adaptation too costly and too risky.

Thus, when the cycle of adaptation is relatively short and predictable, many social changes go on in a loop, without any clear ultimate purpose. Politics works very much like pork farming. When capital is cheap and accessible, i.e. when interest rates are low, governments borrow eagerly and accumulate significant gross debt even without clear necessity. When interest rates go up and indebtedness starts to weigh heavily on the public pocket, budgetary deficits are cut and debt accumulates at a slower rate, or even decreases. That leads to the paradox of counter-efficient fiscal policies, overly lax in the times of plenty and unnecessarily restrictive in the times of scarcity. Although the loop of adaptation is clear, no ultimate purpose can be ascribed to it. It is probably one of the greatest merits of economic sciences to have shown that, most of the time, economic systems oscillate in a set of proximate incentives rather than evolve toward some ultimate purpose.

There are two theoretical reasons for the author to avoid, in this book, the evolutionist distinction between proximate and ultimate causes. Firstly, we never actually know whether the currently discovered link between phenomena is the ultimate one. Something that we may currently perceive as the ultimate purpose of some behaviour might be subordinate to an even more overarching one that we have not grasped yet. That leads to

the second reason, namely that ultimate explanations are frequently burdened with metaphysical causality. When we say that a given behaviour "serves to accomplish the purpose X, Y, Z", what does the verb "serve" exactly mean? This is a point when we try to explain something barely understood with the vocabulary made for describing everyday social life. Serving a purpose means that some people want to reach that purpose, are aware of the opportunity to reach it and agree about the imperative to do so. Here, we touch upon the distinction between collective intelligence through interaction, being the pivotal assumption of the present book, and the collective will to do something. Whilst the former only covers observable phenomena occurring in a sequence of interactions, learning and new patterns of action, the latter is virtually impossible to observe. How can we say what people collectively want? Wanting something is a metaphysical shortcut, which designates the complex correlation between: micro-contractions in certain deep muscles of our body that we experience as satisfaction or dissatisfaction on the one hand, external phenomena on the other hand, and the linguistically simplified association that our brain makes between the two. Individuals frequently do things that they would never admit they want to do, and yet they do them. It is virtually impossible to say what whole societies want. Thus, attempting to offer any ultimate explanations concerning observable social changes is a risky business that the author of the present book tries to avoid as much as possible. When collective intelligence through interaction is assumed, it refers to what evolutionary social sciences describe as proximate explanations, and it stops there.

1.1. The classical, sociological canon set by Émile Durkheim and Max Weber

The classical, sociological canon set by Émile Durkheim and Max Weber, reputed to be the founding fathers of sociology, goes way beyond the scope of sociological science and significantly shapes the way how we perceive the social reality we live in. In the shortest possible résumé, that canon treats social structures as things, i.e. as entities distinct and separate from individuals. In that classical view, social structures just are. Any statement about how they have become what they are, or what will they become in the future, is secondary to the description of their current, actual properties. Émile Durkheim ([1894] [1982]) defined "social facts" as

manners of acting, thinking and feeling external to the individual, vested with a coercive power by virtue of which they exercise control over that individual. Durkheim was convinced that any reliable, scientific reflection about society requires objective observation of such society, with as little ideology as possible. That objective approach, quite rational in many aspects, had led classical sociology toward an Aquinas-like passion for classifications and categorizations, with a clear apprehension vis-à-vis social reality as observable in everyday life. In Durkheim's own words, *when the sociologist undertakes to investigate any order of social facts, he must strive to consider them from a viewpoint where they present themselves in isolation from their individual manifestations* (Durkheim 1982: 83). [...] *Every sociological phenomenon, just as every biological phenomenon, although staying essentially unchanged, can assume a different form for each particular case* (*ibidem*: 91).

Durkheim was also very strongly attached to the distinction between normal social phenomena and pathological ones. He frequently used an anthropomorphic metaphor, namely the distinction between health and sickness, a path that led to many contradictions in his own reasoning, and finally he settled for a more mathematical approach, stating that a social fact can be considered as normal when it takes place in an average society of a given type, at a given stage of its evolution. From that, Durkheim derived claims that would seem controversial even today, let alone at the end of the 19th century. He stated, for example, that criminality plays a normal role in social life and is not necessarily a pathological phenomenon in itself. Normal or pathological should always be defined in relation to what Durkheim called "social species", and what today can be simply defined as types of societies. The sharp distinction between ideally stated norms and the actually occurring facts led to another original distinction in Durkheim's writings, namely that between outcome and function. He claimed that the function of any social phenomenon is the purpose that we ideally assign to it, to be sharply distinguished from the actual outcomes of that phenomenon. The former consists, essentially, in what we collectively want as a society, and the latter is a priori random (or almost). Consistently with that distinction, Durkheim claimed that the state, as one of the fundamental social structures, does not have any specific purpose of its own. It just has outcomes, which, in turn, are specific to the coercive properties of the state. The state can impose some patterns of behaviour on individuals, but it cannot actually create those patterns.

Writing in the times of the first fascination with Charles Darwin's concept of evolution, Durkheim frequently referred to the evolution of societies, although he seemed to look at evolution very idealistically, as an endogenously driven process of betterment. He tried to incorporate the ideas of evolutionism into his own doctrine through concepts like "inner social environment". Yet, at this point, his theory displayed the well-known problem of basic evolutionary applications, namely the difficulty in distinguishing the environment from the interactions with that environment.

Whilst trying to objectify social phenomena, Durkheim was very strongly attached to using sociological methods to explain ethics and law. Thus, although demonstrably non-psychological in his explanations, he constantly returned to the central question: why we collectively do what we do. Max Weber, almost Durkheim's contemporary, went even further in his objectification. He simply stated that any social action, in order to be truly social, must stem from some conscious intention. That was about all that Weber had to say in this matter as he did not go further in explaining those intentions. He considered social structures as something that simply is (1922–1978).[1] In his theory, the state as such can be defined only by reference to the "modern state", i.e. the form of constitutional state known at the turn of the 19th and the 20th century. Max Weber classified the state as one of the political and hierocratic organizations. A political organization, in Weber's view, is a ruling, compulsory, political organization with continuous operations, whose existence and order is continuously kept within a given territory by the threat and application of physical force by the administrative staff. That staff successfully upholds the claim to the monopoly of the legitimate use of physical force in the enforcement of internal order. By contrast, hierocratic organizations are those which enforce their order through psychological coercion, by distributing or denying religious benefits. Max Weber tended to reify social phenomena and, consequently, did not attribute any specific purpose to the state, and neither did Émile Durkheim.

The main difference between Durkheim and Weber, as for the theory of the state, lies in the role attributed to mental coercion. Durkheim firmly maintained that the state, in order to be operational, needs some kind

[1] The essential points of Max Weber's theory, presented in this chapter, are based on the posthumously published book: *Economy and Society* (Weber 1978), University of California Press.

of cultural, symbolic hold on the individual. Without those symbolically imposed, collective patterns of thinking about social reality, the state cannot successfully impose physical coercion. Weber was more prone to theoretical purity and sharply distinguished the political organization of the state from the hierocratic organizations of religious communities. Whilst he admitted the role of religions in the formation of states, he drew a clear boundary between the two.

When we move to the junction between capitalism and political power, the two classics presented quite different attitudes. Émile Durkheim openly stated that his interest in social sciences was deeply rooted in ethics and law, with economics and their methodologies being certainly interesting, but alien to him. In his *Debate on Political Economy and Sociology* (Durkheim 1908), Durkheim admitted that political economy, with its rigorous focus on observable facts rather than ideals, is methodologically close to perfection and can form the basis for other social sciences. Still, he contended that what we observably do is largely determined by what we think, and that the latter is imposed culturally, as the ideals to follow. The heritage left by Durkheim indicates, in other words, that if capital consists of valuable assets, the value of those assets is to a considerable degree dictated by cultural beliefs. If we study the link between capital and political power, we have two different objects of value. Political power is precious in itself. With the exception of very idealistic individuals, being higher in social hierarchy and having more impact on other people's behaviour is an asset in objective terms. Political power is like a container that one can fill with whatever can be held inside. Happiness and beauty cannot be, but capital can. Political structures are containers that can hold capital inside. As for capital in itself, it can consist of objects valuable either because of their sheer, objective scarcity in a given state of technology (e.g. navigable coastlines, natural oil, rare earth metals), or because of their subjective, cultural attractiveness (e.g. art collections, trademarks). The connection between capitalism and political power is heavily dependent on another link, namely that between political power and all those social phenomena that pertain to scarcity and valuation of assets. If the state is active in creating technologies, markets and fashions, it can be the steering component in relation to capitalism. If, on the other hand, political structures are passive in that respect, capitalist structures grab the wheel, so to say.

In contrast to Durkheim, Max Weber had very elaborate economic views. With his typical punctiliousness, he started with minute

definitions of economic activity, economic goods, etc. His general contention was that economic activity, in the sense of purposeful accumulation of profit-making assets, can take place in many organizations, including political ones. To Weber, combining capitalist strategies with those aimed at acquiring political power was something natural. Interestingly, Max Weber did not really admit the things going the other way round, i.e. that capital was used to acquire political power. In the Weberian world, power was power and profit was profit, period. They could go along, but they were distinct. If a capitalist used his assets to influence governments, or to become government, he was not a capitalist anymore: he entered a different game. On the other hand, Max Weber was unusually realistic (even in comparison with many modern economists) as for the practice of public finance and accounting. He openly admitted that the state can hold capital balances completely independent of current budgetary flows and even hardly detectable to the non-initiated observer.

1.2. Fernand Braudel and the "set of sets" theory

The purpose of the present book is to study the future possible role played by constitutional states in addressing major civilizational challenges. Amongst the sumptuous diversity of social theories, those focusing on change seem more interesting than those interested in fixed patterns. As a change is in focus, the works of the French historical school, and especially those of Fernand Braudel, seem a cornerstone. In probably one of his most extensive works, the two-volume book entitled *Civilisation and Capitalism* (1981, 1983), Fernand Braudel made three claims that informed the general direction of the present book. Firstly, the social structure that we name "the state" is just one of the many social structures in place, as the society is "a set of sets" according to Braudel. Secondly, and quite defiantly regarding the current doctrine of economic policy, capitalism is something distinct from and overarching market economy. Thirdly, all the social structures and institutions are always an adaptation to the current proportions between demographic growth and the amount of available resources. These three basic statements deserve to be developed here, as they underlie the main threads unwoven in the present book.

The concept of the "set of sets" comes as a kind of polemic with Max Weber's nicely phrased, sociological definitions.[2] Whilst the latter liked neatly defined categories, Fernand Braudel claimed that the wealth of empirical material offered by any serious study of actual societies makes the distinction between the political and the economic, or between the economic and the institutional very much useless. Whilst not negating completely Weber's perspective, Braudel proposed a general assumption that the society is "a set of sets", which, when applied mathematically, means that various criteria of aggregation can be used in parallel, depending on the problem at hand.

In the most general way, social sets can be approached as combinations of networks and hierarchies. Networks represent the foundation of economic cooperation, thus essentially markets, whilst hierarchies are structures of power and governance. A significant observation by Braudel is that hierarchies form when two preconditions are fulfilled: the density of the population reaches and possibly exceeds a critical level, and the networks of economic cooperation generate a surplus of valuable resources. The appropriation of that surplus, in the presence of a relatively dense population – thus in the presence of relatively intense competition – is the primary gain at stake in the formation of hierarchies. According to Braudel, all known societies are "diversified pluralities", i.e. many alternative hierarchies exist in parallel, compete against and cooperate with each other. Hierarchies formed on the basis of primary networks of economic exchange enter into secondary networks of cooperation, etc. One of Braudels" most fundamental, empirical observations was that all the developed societies (i.e. those with significant economic activity and relatively dense populations), throughout history, including the modern society, have been and still remain astonishingly unequal in the distribution of hierarchical power and wealth. Against that general landscape of social organization, the state according to Braudel "was a looming presence, the coming together of many things" (1983; 514–555), which had two basic functions: to secure obedience and monopolize the use of force in the society, as well as to assure control over economic activity, i.e. over markets and resources. In order to achieve those two primary outcomes, the state had to participate very actively in culture and in the spiritual life of the society.

[2] This particular component of Fernand Braudel's theory can be found in Braudel 1983: 458–475.

Early on, primitive political hierarchies were based on the personal estate of the ruler, but the state needed steady access to capital. Therefore, it needed capitalism and markets by its side. Fernand Braudel observed that, historically, systematic public borrowing (i.e. recurrent and following recurrent legal patterns) appeared before systematic taxation. He even believed that the latter was based on the former. According to Braudel, tax systems in their early phase were largely based on tax farming. Sovereigns made agreements with a selected number of powerful merchant and/or aristocratic families and commissioned them to collect taxes on behalf of the state in exchange for financial advances. Those advances had the legal form of bail, officially backing up the process of tax collection. Only the excess of taxes collected over the bail deposited was due to the sovereign during or after the fiscal year. Yet, as Braudel pointed out, the bails advanced by tax farmers rather than collected taxes were the actual source of cash for the state. The heavy reliance of states on public borrowing, much more substantial – according to Braudel – than the basic budgetary arithmetic could indicate, additionally stimulated the development of capital markets as public debt progressively became securitized and thus entered the current financial circulation. In Braudel's view, the real, actual power of a given state was very closely, and reciprocally, linked to its borrowing capacity.

At this point, we should invoke the second fundamental claim made by Fernand Braudel, i.e. the distinction between capitalism on the one hand and the markets for goods on the other hand. Braudel used to divide the economic life of societies into three distinct fields that he called "layers". The bottommost layer was the so-called material life, made of basic productive and consuming activities at the autarkic level, without any surpluses to trade, and thus not impacted at all by market mechanisms. When the density of population and the relative abundance of resources passed the threshold of superfluity over the current needs, markets of goods developed with their pricing mechanisms. One of the most original observations by Braudel was that the markets of goods were networks, and on the top of those networks active hierarchies developed, capable of manipulating the markets as such and being capitalist structures in the strict sense of the term. The basic tool of manipulation was the power of monopoly, legal or actual (i.e. the actual control of important stocks). Thus, capitalism emerged when active hierarchies were formed on the basis of markets and those hierarchies gained the power to control prices, the quantities traded and the key resources necessary for market exchange to happen. From this point of view, capitalist structures

were very similar to states and bound to form whenever the coordinated control of large amounts of resources was both possible and required for the successful conduct of market activities.

The notion of balance between sufficiency and superfluity of resources and goods, as a key factor in the formation of social networks and hierarchies, leads us to discussing the third "big" assumption made by Fernand Braudel: social structures and institutions are always, at their most fundamental level, an adaptation to the available resources and to the density of the population supposed to use those resources. Significant institutional changes leading to the emergence of the contemporary constitutional state took place on the rising tide of demographic revivals after major demographic slumps, associated with big waves of technological change. There were three such big revivals after big depressions. The first one was noticeable between 1100 and 1350, and it was that mounting flow of population that made the background for the first entity recognized as a modern state, namely the Kingdom of Sicily under Frederick II (1194–1250). During this period, Europe developed its system of agriculture and food supply, which reached the limits of its capacity about 1350. Between 1350 and 1450, the European continent experienced a significant demographic and economic depression. The trend was reversed after 1450, and it was the turn of wind power and waterpower to be harnessed with the technology of mills. That technological wave was associated with another leap in the institutional development of the state: it was precisely when the three monarchs that Francis Bacon called "Three Wise Men", namely Henry VII Tudor, Louis XI of France and Ferdinand of Spain, created really modern states, with armies, financial systems and distinct administrative structures. After 1650 until about 1750, Europe experienced yet another demographic depression, and we can say that the pattern of constitutional, republican state that we know today did not emerge until after 1750 and its emergence was associated with the development of large–scale industry. Interestingly, each of the major technological waves in question required considerable reallocation of capital.

1.3. Jürgen Habermas and discursive politics

One of the leading threads in this book is the question how the state acquires a given amount of political power. We can describe this power in the rigid terms of classical sociology as the monopoly for legitimate

constraint, or as a subtler and fluid game of capitalistic influences, in the lines of the French Historical School. Still, two central observations remain. Firstly, in different countries and at different moments in time, governments have different power over their countries. Secondly, that actual amount of power somehow oscillates around the constitutionally stated powers of the state, never matching them exactly. Jürgen Habermas (1975, 1979, 1996) took those two social facts as the starting point of his theory, which assumed that law and the political system have common roots and take on their current form on the basis of a common process, which he named "discursive legitimation". Habermas stated that law and politics are in constant interaction. The law is a normative manifestation of political power, and politics is a practical implementation of the law. Both need each other as the political system requires some kind of a commonly accepted normative basis, and the law needs to be backed up by some kind of real political power. Law and politics are formed through a process of social communication, which – and this is maybe the most salient point in the entire theory of Jürgen Habermas – is essentially rational. Societies have their systems of internal communication, which combine different levels of formalization and include language itself. Social communication is very much focused on the rules of conduct to be followed in the society and on the political power to be conferred on those in charge of enforcing those rules. At the most fundamental level, social communication relates to the social reality itself, i.e. to what social facts there are to be observed. As humans infer their expectations from currently observable facts, expectations are formed discursively, too, on the basis of different assertions as to what is real. Since both facts and expectations are constantly questioned and discussed, social communication is naturally complex, with a tendency to a growing complexity. Complexity gives rise to systematic, cognitive dissonance, which, in turn, being naturally painful to humans, leads to an almost compulsive simplification. The desire to simplify is probably the origin of incorporating the Aristotelian postulates of rational social order into the process of discursive legitimation. Since Aristotle there has been a kind of constant tension between the functional need to provide for with the help of law and politics at a given moment and place and the general requirements of Aristotelian practical reason. This tension created a multi-layer conceptual structure combining morals, law and politics. Habermas stated that the legitimation of law and, consequently, that of political power, must necessarily harmonize with such moral concepts as universal justice

and solidarity, as well as with individual and collective human rights. These are not "modern fancies": they are simply the paths of discursive legitimation that give rise to relatively the least important cognitive dissonance. The idea of constitutional state broadens the perspective of discursive legitimation as it allows to move from individual rights to an organization. Reflexive application of law to political power leads to the backing of political authority, besides the monopoly to use force, with the popular authorization of political action. Once this second pillar of political power is created, coercion is no more sufficient to hold power: legitimation becomes necessary.

In order to assess the efficiency of political systems, Jürgen Habermas proposed the distinction between, respectively, the input and the output side of political action. The input consists of popular legitimation while actually implemented policies make the output. Mature democracies display a significant dilution of legitimation at the input end of the system. Electoral success depends crucially on the support of the so-called undecided voters, whose behaviour is never predictable and who are usually attracted only by very cautious and timid rhetoric. As for the output side, Habermas pointed out the fact that any administrative system can operate self-consciously only up to some critical size of operations, and that size is usually comprised within quite a narrow interval. When administrative structures exceed that size of immediate response to direct steering, policies tend to focus on avoiding crisis rather than planning something new. As diluted popular legitimation is combined with a limited capacity to steer the administration of constitutional states, "politics go bleak". Habermas pointed to significant differences between individualistic explanations of political phenomena (which he called an "economic theory of democracy") and approaches based on systems theory. The "economic theory of democracy" is grounded in the individual rationality of voters and politicians. It attempts to prove that individual egoistic claims and actions taken to satisfy them collectively combine to produce both the political structures and policies generated by those structures. Political systems, and especially constitutional states, are complex agencies, channelling individual interests, however self-enlightened those interests could be. Those agencies act as markets where the promise of imposing someone's claims on the society is exchanged for political support. On the other hand, the systems theory perceives social systems as complex networks of autonomous subsystems – e.g. politics, law, business, etc., distinguished by the semantic structures they use (i.e.

the language spoken in their internal processes). Those systems are so autonomous that they become "autopoietic", i.e. a prevalent part of their energy goes into self-preservation and self-programming. Administrative structures of constitutional states are such subsystems, and their peculiar trait is the capacity to run an unofficial circuit of political power: the executive branch of government programmes itself through the legislative bills it proposes and by organizing political parties so as to extract as much political support as possible from the citizens. It is worth noticing, as a meta-remark to Habermas' view, that the economic theory of democracy emphasizes the legislative functions of the state, i.e. the activity of politicians elected in a popular vote. The systems theory focuses more on the executive administration of the state. Thus, the relative preponderance of either of those theoretical views depends on where we locate the core of power in the political system.

1.4. The utilitarian view of the state

The debate about the capitalistic aspects of political power refers to economics, among other disciplines. Who says economics, says Adam Smith. Who says Adam Smith, says utilitarianism, the influential intellectual stream than can be traced probably to John Locke, although Aristotle seems to have been much of a utilitarian, too. Understanding the fundamentals of utilitarianism is important for the understanding of any economic view of the state, e.g. the policies usually covered by the general term "economic policy" and pertaining to public finance and financial markets. Utilitarianism is to the Western culture what Confucianism has been, and still is, to Asia: both claim that individuals should develop utility of social actions, as the more they do, the greater the total utility generated in the community is, and the better all that community fares. Utilitarianism had a tremendous impact upon our way of thinking about social structures. It is important both to understand the context in which utilitarianism emerged and its postulates. As for the context, let us travel back in time to the second half of the 17th century, when John Locke anonymously published his essays (Locke 1998 [1689]). It was a time when, after two centuries of almost uninterrupted development into prosperity, Europe started to glide down, again, into demographic and economic depression, accompanied by a resurgence of wars, armed rebellions and a general dismantling of seemingly perfect institutional orders. When

the social reality around us crumbles into pieces, we have two ways of apprehending the crisis: go with the tide of destruction or find a way to create something better. John Locke professed the latter way. He claimed that, with the scientific knowledge available to the people of his time, it was perfectly possible to design and implement a viable social order which could revert the destructive trends observable all around. Being methodical, he first undertook to demonstrate that such a change is possible; he claimed that any social order is made by men and not imposed by any deity. Starting from a hypothetical state of nature, humans have made and tried many social orders, and our current social order is just one more step on that way. "We are born free as we are born rational" – that short phrase, opening paragraph #61 of his essay on civil government, summarized his views upon the social order. In Locke's times, that claim was both foundational and outrageous. It was foundational as it essentially said: "so you don't like that king? Well, your ancestors elevated that king's grand-grandfather to where he is now, and we can take him down; this is all rational calculation". It was outrageous, as it contested the established social hierarchy. Locke did a lot to soften the edge of that blade (and probably to save his own life), yet the germ was there and started to sprout. The idea that societies can be rationally designed by their members became the foundation of modern constitutional democracies. As early as at the end of the 17th century, in John Locke's time, reason and science were closely associated with mathematics, and that very epoch gave rise to a great wave of its practical applications. The invention of the metric system, the meridian division of the Earth, the successes of exact mathematical calculations in business and public policies: all these practical discoveries brought mathematics into close contact with the utilitarian thought. Almost one century later, social scientists started to come up with very convincing proof that mathematics can be used to design social systems. In 1760, Victor Riqueti, Marquis de Mirabeau, published his *Théorie de l'impôt*, closely followed by François Quesnay and his *Tableau Economique* in 1766. Both writers convincingly demonstrated that tax revenues and borrowing needs of the French sovereign can be very accurately predicted and rationally governed, with sufficiently rigorous calculations of the overall economic activity in the kingdom. In 1776, Adam Smith published *An Inquiry Into The Nature and Causes of The Wealth of Nations* in which he convincingly demonstrated that the prices of basic goods (such as metals, corn and money itself), and especially the long-term trends in these prices, were astonishingly consistent over time and across space and very closely

connected with their social context. That wave of economic thought at the end of the 18th century marked a turning point in the social role of utilitarianism. From an elitist intellectual stream, it evolved into a state doctrine based on numbers and cold calculation. The works of John Stuart Mill in Britain (2004a [1844], 2004b [1879]) and those of Jean-Baptiste Say in France (2011 [1803]), both published during the first half of the 19th century, were very representative for the transmutation of moral utilitarianism into a discipline called "political economy" at the time (the contribution of Austrian economists a few decades later was needed to turn it into "economics'). Both Mill and Say claimed quite plainly: any social action generates a certain amount of net utility to the social environment; individual utilities can be measured; summed up, they make the aggregate utility of the society, which obviously can be measured too; the central concern of any form of collective governance is to maximize that aggregate utility. Capital is essential to business activity and to creating utility in marketable goods, hence the accumulation of capital is required to maximize aggregate utility. Attracting investors to the national territory has gradually become one of the main points in any economic policy practised in the world. Utilitarianism, with its development in economic sciences, traces a mutual connection between capitalism and political power: well governed states attract capital, and a sufficient amount of capital present in the national territory guarantees the maintenance of sound public governance. Conversely, bad public governance scares investors away, and the resulting absence of a comfortable cushion made of private capital makes sound public governance even harder to achieve. With time, and mostly by way of practice, good and sound public governance has become a general label for: free market economy, low taxes, low interest rates, low barriers to trade, stable exchange rates, flexible labour contracts, political stability (or at least political predictability) and constitutionally guaranteed possibility of judicial arbitration between business investors and governments. Thus, a certain model of capitalism has emerged as congruent with the modern constitutional state and, complementarily, the modern constitutional state has taken shape as a structure capable of accommodating that pattern of capitalism. That accommodation can be summed up into the concept presently known as "systemic risk': governments are supposed to act so as to reduce the overall risk incurred by investors. It is interesting to notice that, dressed in the economic suit, the initial utilitarianism of John Locke, postulating rational and purposeful shaping of social structures, has evolved into a very rigid vision

of public order, centred around one model of society that we call today "the democratic state".

Utilitarianism is well-known for its organic metaphor, used by many proponents of this intellectual stream: society is like an organism, for example like the human body. Each of the parts – organs, limbs, subsystems – works optimally when in balance with the others and, on the other hand, the overall health of the organism comes from the individual states of health in its individual parts.

1.5. Thomas Malthus and the demographic factor

There are unlucky prophets who profess their ideas at the wrong time and at the wrong place. Thomas Malthus was such a prophet in the field of social sciences. Writing and publishing slightly after Adam Smith and contemporarily to John Stuart Mill, Malthus had the misfortune of writing something clearly distinct from those writers (Malthus 1998 [1789]; 2011 [1836]). He was probably one of the first social thinkers to be qualified as an ecologist. In a social environment of a fast demographic growth in Europe following the demographic slump of 1650–1750, and in an intellectual environment focused on producing visions of social improvement, Thomas Malthus wrote: *It is an obvious truth, which has been taken notice of by many writers, that population must always be kept down to the level of the means of subsistence; but no writer that the Author recollects has inquired particularly into the means by which this level is effected: and it is a view of these means which forms, to his mind, the strongest obstacle in the way to any very great future improvement of society* (Malthus 1998 [1789]). Society, according to Malthus, grows geometrically in terms of headcount, but just arithmetically in terms of basic resources. In the context of that basic statement, Thomas Malthus had the misfortune to formulate one expression that led to his being ostracized by some mainstream social thinkers: "a positive check to the population". That positive check meant actions which repress demographic growth in its infancy. His reasoning was most humane: population is going to be checked anyway, when it hits the limits of available resources, only such a spontaneous check will be brutal, and brutal mostly to the poorest. In other words: when we run short of food, the first to die will be the malnourished. By checking the population positively, Thomas Malthus meant some kind of social engineering that he openly admitted

not to have been able to design exactly, which would repress demographic growth to keep it in step with the arithmetical growth of resources. In order to grasp fully the meaning of Malthus' thought, it is useful to recall the difference between arithmetical and geometrical growth. The former means that we add up, the latter means that we multiply. Thomas Malthus was very strict and realistic about the economic accounts, following the path set by the French economists and by Adam Smith. He assumed that no matter what resources we consider, accumulation is the basic pattern of economic growth. Every year a gross gain is added, something depreciates, and the net outcome of gross gain and depreciation is net accumulation. On the other hand, geometrical growth means that the base is being raised to a power greater than one: it multiplies by itself (simple reproduction) and generates a surplus (growth). Arithmetical growth can stop at any moment: we simply stop adding up; geometrical growth is essentially self-propelling and can go on infinitely unless it hits a barrier. As it is frequently the case with intellectual creation, Thomas Malthus presented his most interesting ideas when involved in a polemic rather than in a regular exposition of his ideas. From this point of view, chapter 10 of his *Essay on the Principle of Population* is maybe the most interesting of all. It is an elaborate polemic with William Godwin's *Enquiry Concerning Political Justice* (Godwin 1793). Godwin claimed that political institutions are of absolutely cardinal importance in social development. He followed in the footsteps of John Locke and looked for a perfect social design, able to ensure perfect social well-being. The key to establish the right political institutions is the right spirit in the society, and the right spirit is likely to emerge only when the society lives in wealth. Through patient, collective effort, the material well-being can progress and institutions can improve. Thomas Malthus opposed this view. To him, *human institutions appear to be the obvious and obtrusive causes of much mischief to mankind, yet in reality they are light and superficial, they are mere feathers that float on the surface*. Malthus claimed that even in a situation of objectively existing wealth, egoistic attitudes would persist. In that context, Thomas Malthus formulated an amazingly far-reaching thought: from the objective point of view, humanity has plenty of available resources, we just do not know how to use them. The real demographic challenge is to keep the population down to the resources that we know how to acquire, not to all the resources really available. It is the effort of acquiring new resources in the presence of geometrical demographic growth that can cause social unrest, not the absence of resources as such. In the same Chapter 10,

in his polemic with William Godwin, Malthus claimed that *three fourths of the habitable globe is now uncultivated. The parts already cultivated are capable of immeasurable improvement. Myriads of centuries of still increasing population may pass away, and the earth be still found sufficient for the subsistence of its inhabitants. I have already pointed out the error of supposing that no distress and difficulty would arise from an overcharged population before the earth absolutely refused to produce any more*.

The essential message formulated by Malthus was that the limits to demographic growth lie in the way we use the resources available, rather than in the absolute amount of those resources.

1.6. The theory of social contract: Rousseau and Rawls

Somewhat in the shadow of the utilitarian paradigm, another social philosophy gradually took shape: that of the social contract. In 1762, Jean Jacques Rousseau published *Le contrat social* (*The Social Contract*; Rousseau 2010 [1762]). Rousseau started with a general assumption that social order does not come from nature, but from an agreement between the members of the society. Rousseau wrote that *the social order isn't to be understood in terms of force; it is a sacred right on which all other rights are based. But it doesn't come from nature, so it must be based on agreements. Before coming to that, though, I have to establish the truth of what I have been saying* [*ibidem*].

The reference to a social contract that underlies social order is peculiar to the whole school of social contract, especially in the theory of justice by John Rawls, which will be discussed later. For the moment, it will be interesting to follow in the footsteps of Jean Jacques Rousseau. One of his most pertinent remarks about the institutions of the state was that the latter progressively evolved from being a community of men into the status of a territory. Rousseau demonstrated how the progressing institutionalization of private property in real estate had created a close link between private owners of large domains and the sovereign. The state evolved as the mere sanctioning of natural possession turned into the exclusive right of ownership. That right required some kind of guarantee, which naturally relied on the authority of the sovereign. The latter, in order to be able to protect private property, needed exclusive authority over the territory. This is how private property rights as for real estate progressively became distinct from sovereign's rights over

a territory. The latter had given rise to the modern concept of state understood as territorial sovereignty that backs up and guarantees the enforceability of private claims.

As Rousseau wrote:

> We can imagine how adjacent pieces of land belonging to individuals become, when they are combined, public territory, and how the right of sovereignty over the subjects comes to be extended to being a right over their real estate. This makes the land-owners even more dependent ·on the sovereign; they have more to lose if things go wrong between them and the sovereign; and· this is a guarantee of their fidelity. The advantage of this apparently wasn't felt by ancient monarchs, who called themselves kings of the Persians, the Scythians, or the Macedonians, apparently regarding themselves as rulers of men rather than as masters of a country. Today's kings are cleverer: they call themselves kings of France, of Spain, of England and so on. Holding the land in this way, they are quite confident of holding the inhabitants. This alienation in which individuals transfer their goods to the community has a special feature, namely that far from depriving the individuals of their goods it assures them of legitimate possession, changing "I have taken possession of this (somehow)" into "I have a genuine right to this", and "I have the enjoyment of this" into "I own this". Thus the possessors, in their role as those to whom the public good has been entrusted, and having their rights respected by all the state's members and maintained against foreign aggression by all its forces, have made a transfer that benefits both the public and still more themselves, thereby acquiring (as it were) everything that they gave up. This paradox is easily explained by distinguishing the sovereign's right from the owner's rights over the same estate – as we shall see later on [Rousseau 2010 [1762], p. 11].

Rousseau assumed, as the contractarian school assumes until today, that the society we are currently living in has evolved from some kind of primitive (primary) community. If we want to understand the way our own society works, we need to understand both the patterns of that primitive social state and the distance that we have covered since. Rousseau shared that assumption with John Locke, although they differed about its application to the current social order. Locke claimed that the social contract agreed in ancient societies is a foundation that we should build upon without altering it. Conversely, Jean Jacques Rousseau considered the social contract as essentially flexible and adaptable. This is the peculiarity of the contractarian school: any social contract that the parties (the society) can agree upon freely and responsibly is valid and just.

The contractarian school in social sciences has been lagging behind utilitarianism in terms of popularity and translation into actual public policies for more than two centuries, and still it has something original to bring to the table as we are facing global crises. In 1971, John Rawls presented his contractarian theory of justice understood as fairness, and revised it officially in 1999 (Rawls 1999 [1971]). The originality of John Rawls' theory lay in his demonstration that a just society is also the most resilient to crises and able to sustain its existence better than utilitarian policies. The starting point of his theory is the basic question: why should we arrange our society in a just manner? Why not stick to "a kind of justice" and focus only on multiplying the aggregate wealth of the society? In order to explain that, Rawls presented a theoretical construct that he dubbed the "original position", i.e. a hypothetical state of things that any negotiation and any contract starts from. The very concept of the original position had its source in an empirical observation: when social conflicts arise and lead to significant social changes, e.g. in the constitutional order, societies ask themselves collectively what their most fundamental, commonly shared principles and norms are. This is why practically all the legal orders in the world have a hierarchical structure, with constitutional principles providing the foundation of any other rule. That almost intuitive habit of going back to the basics when in doubt is present in the settling of most social conflicts. If we want to ensure peaceful outcomes to such conflicts, negotiations necessarily require stating what we want, and whether what we want is acceptable to other parties.

When people start negotiating a contract, the initial knowledge they have access to is crucial for their success in negotiations. Those who know more about the matters being negotiated and drafted as a contract, usually earn more as the contract is consumed. Still, there are situations so uncertain, burdened with so many unknowns that no one can say they reliably can predict what will happen next. Rawls called that state "the veil of ignorance". From Rawls' point of view, when setting the fundamental principles of a social order, we as a society are in such a situation. Social orders are so complex that any legal regulation is burdened with the veil of ignorance: neither the government nor the citizens can predict with acceptable probability the outcomes of new rules. Rawls did not make reference to any real public policies and, as a matter of fact, he avoided any such references, but many examples can draw the attention of his reader. Maybe the most textbook one is the classical syndrome of angry protesters. When public protests arise, governments intuitively respond by sending law enforcement

troops to control the situation. As protesters spot the presence of law enforcement troops, the mood frequently heats up and the protest turns into a riot. This is not always the case, yet there is no way to predict the exact outcome of those attempts to "control the situation". More examples can be cited. Extensive public programmes for the construction of affordable residential houses frequently end up in a spectacular increase of land prices and, consequently, in a lower average affordability of any residential real estate. Monetary policies, designed to control tightly the situation in financial markets, require very close, hands-on supervision and quick corrections of their course. Regulations pertaining to the labour market frequently only increase the rate of unemployment instead of raising the minimum wage. Of course, the exact outcomes of those situations pertain very much to the efficiency of public governance, nevertheless the general point is that past a certain level of complexity, no one can predict the exact outcomes of laws and public policies. This is the veil of ignorance in practice.

Using the veil of ignorance as a conceptual tool, John Rawls asked another question: how we arrange our mutual relations – in a private contract or in a social order – when we are burdened with the veil of ignorance? The answer is quite simple: we arrange, in the first place, for accurate responses to our actions on the part of other social agents. We make sure that our actions will be mutually fair. Gaining a reasonable assurance concerning fairness in the actions of our partners in the contract is a logical step forward. Once we have gained that assurance, we can design more complex contracts and constitutions. This is John Rawls' original position – when we know very little about the future, the first thing to gain certainty about is the conduct of our partners in the contract – and this is how fairness emerges as a natural foundation of social order. If we want a social order resilient to economic crises and political turbulences, we should ground it in the principles of fairness, derived from a hypothetical original position. This is maybe the most delicate point in John Rawls' theory of justice: he argues that the social order should be grounded in a hypothetical original position.

1.7. Herbert Hart's theory of law

The state means law, to a large extent. The evolutionary path of constitutional states consists very much in the progressive development of a good match between political power and legal order. The emergence

and development of the legal order marks the process of change in the State as a type of social structure.

In that respect, it is interesting to compare the classic, Weberian view of the state based on coercion with the classical theory of law formulated by Herbert Hart (Hart 1961). In the first place, Hart formulated some interesting observations about the behaviour of governments in international relations (*ibidem*: 213–237). Although states are basically sovereign and under no jurisdiction save for their own, governments tend to abide by some clear rules in international relations. Whether those rules are considered only as customs, or more ambitiously as "international law", their common trait is that they emerge spontaneously as commonly accepted ways of arranging mutual relations. For Hart, it was living proof that a legal order can emerge without coercion. It should be noted that Hart's classical theory was formulated in the 1950s, when much of what we consider today as natural was absent from international relations: European communities were just starting to form, and global organizations such as the United Nations or the World Trade Organization were in their toddler's years. The subsequent formation of those big structures seems to prove Hart's essential insight, namely that rules of conduct, at many levels of social aggregation, emerge spontaneously even if we cannot exactly trace back their validity.

The second important observation that Herbert Hart made regarding international law was that there is indeed a vague space in international relations, made of rules that we cannot unequivocally identify as international law. This is because it is relatively harder to assess whether a government is bound by a given rule than it is in the case of individuals. Persons can be relatively easily ascribed to jurisdictions and, consequently, to respective systems of binding legal rules. Of course, there are special cases, yet they can be adjudicated according to the same principle: jurisdiction leads to the relevant legal system. In the case of states, it is not that simple. One of the basic principles of constitutional law is that of national sovereignty: states are sovereign in their territory. There is no a priori jurisdiction over a state. Of course, governments can join the jurisdiction of international organizations: international arbitration in business cases is a good example. Still, this is voluntary adhesion, not a generally binding rule. In other words, governments play by the rules they want to play, and the rules they want to play are the rules they play by. What seems a circular play on words, reflects an important aspect of public governance: states constantly become as much as they are. In the activity of any

given government, there is always a category of actions and policies that explore the possibilities of new arrangements rather than comply with the existing ones. States experiment with their own institutional structures. When experimentation is really intense, e.g. when governments have to adapt to radically different economic contexts, the twilight zone where facts and legal rules partly overlap might be quite substantial. In stable, predictable situations, there is much less rummaging and experimenting on the part of the state, and the twilight zone subsides.

The coercive approach to the formation of law was something that Hart vigorously criticized. His observation was quite simple: law in action is something qualitatively different from morality as well as from technical norms and pure coercion on the part of the government. The law can be assumed to work as a system when the government does not have to use coercion each time the legal rules should be complied with. The law works when people behave in accordance with it, without guns being pointed at them all the time. The law, in popular perception, is different from morality or technical norms as the law is binding, and those other rules are rather indicative. Herbert Hart's intuition was that social structures spontaneously develop rules of conduct, and some kind of social mechanism assigns various degrees of validity and binding force to those rules.

1.8. The division of powers in political systems

There is a habitual way of thinking about constitutional states as complex structures that combine three branches of government: legislative, executive and judicial. We use to call it the "division of powers" and consider as foundational to any constitutional democracy. One name is just a habitual reference regarding the division of powers: Montesquieu. In 1748, Charles de Secondat, Baron de Montesquieu, published *L'Esprit des Lois*, which in 1752 was translated into English by Thomas Nugent as *The Spirit of Laws* (Montesquieu 2001 [1748]). Montesquieu is frequently named as the first social thinker to prescribe the division of powers as the best way to organize a State. There is just one little problem: he did not. Charles de Secondat, Baron de Montesquieu never formulated the doctrine of mutually separating the legislative, the executive and the judicial branch in government. He could not even think about such a distinction as the government he knew had no branches: it was a maze of criss-crossing competences at various levels of the feudal hierarchy, in various towns

and regions and in various jurisdictions. Montesquieu identified what he called the "three kinds of government" – this is absolutely true – only they were: democracy (or republican government), monarchy and aristocracy (or despotic government). Democracy was constituted by the general will of the people and should be governed by virtue. In monarchy, the prince is the source of all laws and all power, and that kind of State should be governed by honour, moderation and ambition. Aristocracy is a structure that endows a small number of people with supreme powers, and those powers should be driven by moderation.

If not Montesquieu, then who? Who was the inventor of the three mutually separated powers in a constitutional state? Probably no one as an individual or, rather, the society as whole invented that distinction. Tribunals emerged as separate authorities already in Antiquity, yet adjudication had remained a traditional prerogative of sovereigns for ages. According to Fernand Braudel (Braudel 1995), between 1450 and 1650 all the big players in international trade – Spain, Turkey, Britain, Holland, France, the Italian city-states, etc. – developed increasingly complex legal systems. Those systems helped to build empires and, at the same time, required professionals to handle legal cases on all sides of the court bar. This is how lawyers ascended, as a professional group, to their full social importance known today. This is when (i.e. between 1450 and 1650) modern judicial procedures emerged and a new type of social understanding dawned: aristocrats and capitalists accepted the legal order imposed by kings, as long as that legal order guaranteed adjudication by independent tribunals. By the middle of the 17th century, the more or less pronounced independence of the judicial power became a fact. However, the 17th century did not bring the separation of judicial power as a branch of government. The very idea of the three branches and their constitutional delimitation seems to have its roots in the first American constitution, written and modified many times between 1774 and 1788. The United States of America seem to have been the first country to have a practical issue with dividing the government into branches. In America, such division was a necessity to handle in political, economic and legal terms, not just theory. It can be plausibly assumed that the model constitutional framework that we have today, in any country, is a distant, more or less endowed heir of American constitutionalism. It is instructive to follow the account of Alexis de Tocqueville in that respect (de Tocqueville 2002 [1835–1840]). The first practical issue that the American founding fathers had to handle was the fact that the colonies in America were

the first political structures, in the realm of the European culture, which sanctioned full and unimpeded freedom of movement for all the people living there. No European country before had experienced such a complete freedom of movement. All the European constitutional orders assumed that the great majority of the population stays, with their possessions, in the same, easily identifiable jurisdiction of a city, or that of a lord. In such a system, most of the matters that we use to mean by "public policy" was essentially addressed within precise territories. With the complete freedom of movement in the United States, a different paradigm had to be invented: that of public policies addressed categorially, and not just territorially. It was the moment that the general idea emerged of the law being applicable to all, and in the entirety of a vast territory, in the same way and by the same administrative structures. This, in turn, required the creation of political structures partitioned into vertical departments, or branches, and not just into territorial units. The colonies that confederated in the United States of America had already had their own systems of adjudication, and they brought them to the common table with a reasonable degree of standardization. Thus, the judicial branch emerged as the first. The real problem consisted in the mutual balancing between the respective prerogatives of the legislative and the executive. The member states had previously developed local governments where congressional, elected bodies took most public decisions and carried them out by appointing separate, individual clerks for each task. In terms of the present constitutional systems, we could imagine a parliament voting the policies to implement and appointing separate ministers to carry them out, independently of each other. This was the initial separation of powers in America, and it was very much the paradigm followed in the initial constitutional order of the United States, definitely rejected by George Washington and the people who were supposed to be the executives of the confederate States. From Washington's point of view, such a pattern was simply impossible to follow if his administration was to provide any real governance to the country. A period of trial and error followed, when a compromise between democratic legitimation and operational efficiency progressively emerged and finally took form of the American Constitution that we know today and that has become the foundational pattern for all liberal democracies. That pattern implies that the executive has just as much power as it absolutely needs to carry out the policies voted by the legislative body. The delegated power of the executive was based on another institutional invention: the budget. European monarchies

had a long tradition of more or less negotiable limits of expenses made by the sovereign. Still, as those expenses were covered mostly by a combination of institutionalized tax farming and financially attractive public borrowing, there was quite a sizeable class of wealthy citizens eager to see the monarch spend as much as possible. Besides, in the European monarchies, the frontier between the private sector and the public one was rather foggy, sometimes even inexistent, as Adam Smith observed in *An Inquiry into the Nature and Causes of the Wealth of Nations* (Smith 2005 [1776], Book V, Chapter III On Public Debts). Hence, the European tradition leaned rather towards profusion than towards frugality in public expenditures. In the newly formed United States of America, the situation was different: the habitual pattern, brought by individual colonies to the common table, was that of strictly controlled expenditures targeted at the activities of precisely identified executives appointed by the legislative body. That is, most probably, how the presently known pattern of separation between the legislative and the executive power was born. It is a pattern where the executives of the community are endowed with an annual budget to carry out their tasks. Still, the pattern has evolved since the end of the 18th century. It is worth studying in detail how it works today.

1.9. Attempt at the classification of political systems

Governments are strongly idiosyncratic, which makes a clear and unequivocal classification of political systems a surprisingly arduous task. As one tries to classify political systems, two basic categories can be taken into account, namely the constitutional order of a country, or the way in which political action is effected. Constitutional orders are parts, usually the foundational ones, of national legal systems. Evaluating a constitutional order means assessing what it should do if it worked according to those written rules. In other words, the constitutional order of a country says what its government can do rather than what it really does. A purely legal study of constitutional orders usually focuses on the coercive powers of the state, the limits that the law puts on them and, possibly, the processes that give rise to constitutional law. A classical, encyclopaedic review in that respect is to be found in the work of Nicolai M. Korkunov (1922 [1909]). Constitutional orders are static in the sense that they change at a very slow pace, and there is always some doubt as to the extent to which written rules truly reflect the reality of political governance. Without

leaving completely the world of legal rules, it is possible to give some dynamics to the static constitutional framework by studying the possible freedom of political action, i.e. all the possible policies than can possibly be carried out in a given constitutional order. Game theory comes as a useful theoretical tool in this path of research. The views of Barry Weingast on the economic role of political institutions can serve as an example of a deep insight into the workings of political systems, based merely on the study of rules and the range of discretion they offer to the political class (Weingast 1995). This methodology is based on relatively strong assumptions as for the essential goals and values in the political game. In other words, in a game we have to identify the prize that the winner acquires. Interestingly, Weingast's theory seems to indicate that the appropriation of wealth (capital) is a prize that requires relatively the weakest assumptions. That comes from a simple observation that the concept of "political power" in itself is truly vague when understood as something to acquire and hold. As the possible goals of political players are considered in a political game, "political power" appears to be a means to acquire something else rather than a value in itself. It is possible to move further towards action and away from constitutional rules and focus exclusively on the actual way in which policies are made. Such an approach is to be found for example in the works by Gabriel A. Almond (Almond 1956), who formulated three interesting, general observations. Firstly, such a purely functional approach to political systems is strongly biased by the personal point of view of the political analyst. A policy of social assistance provided to immigrants, for example, can be seen as more or less distributive by someone interested in the social aspect of public governance, or as more or less nationalist from the point of view of international relations. Secondly, the purely functional patterns of political systems seem to be marked with a geographical trait. For this reason, Almond introduced a threefold distinction into Anglo-American, Continental European, and Scandinavian-and-Low Countries systems. Thirdly, as one studies policies, the roles that particular political actors play in policy making offer even more recurrent patterns that the policies themselves. The concept of political roles is central to one of the most recent theories of political systems, namely the theory of veto players as developed by George Tsebelis (Tsebelis 2002). Tsebelis, in line with the functional path of studying political systems, claimed, in the first place, that policies are the basic outcomes of any such system. The content of those policies, as well as the processes that lead to their formation and enforcement, are

the key variables that characterize the actual body politic of any country. As the path of research is functional, one of the fundamental distinctions is between the status quo and change in public policy. Change can occur when an alternative policy has been articulated and when it acquires the fiat of all the veto players, i.e. all the political agents whose agreement is necessary (*de facto* or *de jure*). Any policy, the existing status quo or its possible alternative, can be seen as overlapping between ideological stances and interests of particular veto players. Any policy can be quantitatively measured in terms of the size of that field, i.e. by its capacity to generate political consensus on the part of the existing political veto players. In other words, George Tsebelis considered political consensus as something measurable, and its size as the basic metric of any individual policy. In a pair of policies where the existing status quo can be supplanted by an alternative, both can be assessed as to the respective sizes of consensus they generate, and the bigger consensus wins. Veto players are the building blocks of the political system. Their existence is determined by two sets of factors: constitutional and partisan. Constitutional veto players are those whose political role is explicitly defined in the constitutional order and associated with a distinct institution. The president, the prime minister or any other constitutional role defined by the law are constitutional veto players. On the other hand, political parties or fractions have no constitutional role as such, yet they have a significant impact upon the formulation and enactment of policies. Political players or groups of political players whose position (vote, tacit agreement, public support) can actually influence the maintenance of the status quo or its replacement by a new policy are partisan veto players. Any political system has two mutually interpenetrating structures, namely the constitutional and the partisan one. Each of these two structures can be characterized by the number and the respective positions of veto players, as well as the location and size of the consensus between veto players.

1.10. The economic role of political institutions and Barry Weingast's theory

From the point of view of an economist, political systems frequently seem deeply irrational in their mechanics. To a political scientist, economic systems appear, just as frequently, as simply not subtle enough to give an accurate picture of what is happening at the intersection

of politics and economics. Still, some scientists attempt to conciliate those two universes, and Barry Weingast, professor at Stanford University, is one of them (Weingast et al. 1981). In a seminal paper he attempted, together with two other authors, to provide a neoclassical economic explanation to distributive politics. Weingast et al. started from a basic observation, namely that political systems are notoriously inefficient in distributive policies or, as those authors called it, in pork-barrel projects. The concept of pork-barrel project refers to the fact that political representatives, present and voting in legislative bodies, should basically represent economic interests of their own voters and, consequently, should act so as to channel public funds into the possession of said voters. Let us assume, to illustrate the problem, that three distinct social groups are represented in a political system. We can name those groups A, B and C, respectively, and ascribe them a 30%, 20% and 50% share in the legislative body. Rationally, we should expect that, in the total stream of capital redistributed by the State, those social groups should participate in proportion to their parliamentary representation, possibly corrected with some efficiency coefficients. Yet, as Weingast et al. observed, this is not the case. Political systems seem to be chronically inefficient in proportional representation of economic interests articulated by particular social groups. In an attempt to explain that phenomenon, Weingast et al. defined distributive policies as political decisions that concentrate benefits in a specific geographic region and finance expenditures through general taxation. The focus of that precise study is on project-based distributive policies (e.g. sewage plants, road construction, etc.), which typically address the needs of a specific, geographic constituency and whose benefits are unrelated to those of other projects in other locations. In that respect, distributive policies are sharply distinguished from non-distributive ones, which have no specific geographical target and address the needs of all eligible citizens, however dispersed geographically they may be. Healthcare and educational systems are a good example of non-distributive policies. One of the basic assumptions adopted by Weingast et al. was that the stream of benefits from a given distributive policy grows as the amount of capital allocated in the corresponding project grows, yet the marginal benefits in that function are decreasing. The total cost of producing a distributive project includes three types of capital outlays: those spent in the constituency where the project is located, those expended outside that constituency, and finally non-expenditure outlays (e.g. destruction

of the natural environment). Here comes another basic assumption formulated by Weingast et al., namely that the marginal costs of distributive policies are constant or increasing. In other words, there can either be no effects of scale at all or there can be negative effects. In large projects, the cost per unit of benefits can grow. This is quite a realistic assumption about publicly governed ventures: large scale projects tend to attract a disproportionate number of political players attempting to get a subcontract or a temporary appointment for "my uncle's second cousin". When tackling the funding of projects, Weingast et al. adopted another important assumption, excluding public borrowing from the financing of distributive policies. The full expenditures related to distributive projects are supposed to be covered from the tax bill of the nation.

The economically efficient benchmark for distributive projects is a situation when marginal benefits from the project of a given size are initially equal to its marginal cost, but as the size of project grows, the pace of growth in marginal benefits is slower than the analogous pace of marginal costs. The first possible source of departure from that efficient model is the impact of distributive projects upon local markets. The impact in question is generally a stimulus to economic growth, with one exception however. As large projects are executed, important procurement of production factors is usually needed (e.g. steel, concrete, etc.), which, in turn, leads to higher (possibly temporarily higher) prices of said production factors. That pulling movement in the market makes most economic players happy, except those purchasers of production factors who are located outside of the benefiting constituency and have to buy production factors at higher prices. Weingast et al. argued that in order to assess fully those externalities in factor markets, all the distributive policies in a nation should be pooled together and then checked for the residual difference between the total stream of benefits and the total stream of externalities engendered. On the grounds of the previously mentioned assumptions about the efficiency of distributive policies, the pooled total of those policies is by definition always bigger in size than the efficient solution would suggest. In order to explain that aggregate inefficiency, Weingast et al. disaggregated the process back into individual distributive policies and gave an analytical form to the well-known "none-of-my-business" behaviour on the part of political representatives. Each individual political representative elected to the legislative body by voters from his "home" constituency will maximize the total stream of benefits, as well

as the in-constituency spent costs of distributive policies, whilst ignoring the tax bill of the project and its externalities upon other constituencies. Mathematical development of that decision-making process leads to concluding that the total size of distributive policies that elected representatives attempt to pass through legislation is even greater than the otherwise inefficient total size of the actually implemented policies. In other words, when locally elected legislators work all together and are equipped with that basic logic of maximizing benefits for their individual constituencies, there is no way they could possibly vote for an economically efficient total size of distributive policies. Moreover, Weingast et al. proved quite simply that when the number of distinct constituencies in the country grows, the average local tax bill (i.e. the total national tax bill divided by the number of districts) decreases, but the pecuniary goals of local political representatives do not decrease at the same pace; they are usually higher. As a result, with an increase in the number of voting districts in a country, the gap widens between the total size of distributive policies aimed for and the size actually voted for and, consequently, the total effect of locally targeted is increasingly inefficient.

The formal statement of that last principle opens an interesting window for further research. It says that when the marginal, in-constituency spent cost of a distributive policy is greater than the local marginal tax bill serving to cover its full expenditures (in-constituency and out-of-constituency ones), the size of projects that local politicians strive for is greater than the size actually voted for. In other words, as long as our local tax bill remains lower than the total pecuniary expenditures of distributive projects, we will always strive to maximize the size of those projects. If at this point we include public borrowing into the model, that tendency for over-optimal maximization of distributive policies becomes practically engrained in the political system as long as we assume that most political decision-makers represent essentially the interests of limited social groups and put the perceived interests of those groups before the general good.

A strong claim is formulated for further discussion: the part of the political system responsible for regulating and assuring the economic power of the government can change in a relative autonomy from other fields of the political system. That part of the system is significantly linked to the relative, discretionary freedom of the executive branch in the government.

In his more recent work, Barry Weingast argued that some constitutional orders are much more favourable to capitalistic growth than others and that governments rest their political power, to a great extent, on their capacity to confiscate private wealth, e.g. in the form of taxes (Weingast 1995). He used the concept of "limited government" to designate a constitutional order favourable for the protection of economic and political rights. Weingast claimed that limitations imposed by the constitutional order upon the economic power of governments are to be viewed in the context of a cyclical game whereby the government reaches into the pockets of the citizens in a sinusoidal, intermittent manner. In Weingast's view, most governments have nothing to gain through systematic, continuous control over economic activity, and politicians know they are generally bad at doing business by themselves. Still, most governments are tempted, from time to time, to appropriate large lumps of capital by bending or straightforwardly breaking the rules of partition between the public sector and the private one. Weingast chose the conceptual framework of game theory and constructed a model game between one government and multiple citizens, in which the government can violate constitutional rules, yet, in the equilibrium state of the game, chooses not to do so. The existence of such an equilibrium depends very much on the behaviour of citizens: they must react to transgressions by punishing the government, and must do it in mutual concert. Barry Weingast applied this theoretical framework to a basic empirical observation that the richest nations in history had usually developed federal structures of government. Consequently, he developed the concept of *market preserving federalism*, or a political system bearing five essential traits: a) there is a hierarchy of governments in the same national territory, and every level of government has a clearly delineated scope of authority, b) the autonomy of each government is self-enforceable through constitutional rules, c) subnational governments have primacy over national ones in regulating economic matters, d) a common national market works effectively, and e) lower-tier governments face a strict budgetary constraint, which includes the lack of possible bailout on the part of the central national government. Barry Weingast demonstrated, for example, that China, after the economic reforms had started in the 1970s, is a nearly perfect example of a market-preserving federation. Here we return to the global flows of capital, discussed previously. One of the reasons explaining the relative success of China in attracting capital is a combination

of characteristics typical of all emerging markets – quick demographic and economic growth, fast technological progress – with robust political institutions built into a federal framework and effectively protecting economic freedoms. Strangely enough, that self-limitation of the government in economic matters is accompanied by a very authoritarian rule in other fields, like political freedoms.

1.11. Recent evolution in political systems and in international relations

On the empirical side, the Database of Political Institutions (DPI) published by the World Bank (Beck et al. 2001; Keefer 2012) provides some interesting observations concerning the recent evolution in political systems. The DPI can be seen as a practical application of the veto players" theory: it characterizes national political systems in terms of the number of distinct veto players in those systems (mostly the constitutional players, although the partisan component is present, too). One of the basic distinctions in the Database of Political Institutions is that between the presidential systems, the parliamentary ones and those with assembly-elected presidents. In 1975, when the span of DPI observation started, 54% of the countries studied were presidential systems, 30% were parliamentary ones and 17% were systems with assembly-elected presidents. In 2012, when the data from DPI stopped, that global structure remained very similar, with one change, however: a much smaller percentage of countries (7%) have assembly-elected presidents; presidential systems make up 58% of the sample and parliamentary ones can be observed in 35% of cases. The Database of Political Institutions is a data panel, i.e. each country is observed over a time range of distinct annual observations so as to grasp the possible changes. If we pool together all the "country-year" observations and assess the occurrence of particular systems in such a data panel, we can have a general view of how frequently a given state of nature was observed between 1975 and 2012. Seen from this angle, the global distribution of political systems is similar to that observed statically: presidential systems occurred in 56% of observations, parliamentary ones in 32% of cases, and the remaining 12% correspond to the occurrence of assembly-elected presidents.

An assembly-elected president is essentially the favourite of the ruling party or coalition in the legislative body. Having an assembly-elected

president in the constitutional system is like having another prime minister, and that system introduces some kind of fogginess into the political process: the president is supposed to be independent, but actually remains highly dependent on the current political support of the legislative. In comparison, both presidential and parliamentary systems are much more clearly cut in their constitutional structures. **Thus, a tentative conclusion can be formulated about the pattern of public governance: in general, our global culture seems to prefer clear distinctions in the constitutional structures, to those foggier and more indefinite, with libero-like veto players in the system**.

Another basic distinction in political institutions is that between plural and proportional electoral regimes in the appointment of parliamentary legislators. Plural legislative elections follow the winner-takes-it-all pattern. The country is divided into as many voting districts as there are mandates (seats) in the legislative body, i.e. in each individual voting district there is only one parliamentary mandate to win. The mandate goes to the person who attracted the greatest percentage of valid votes. In theory, plurality in elections is supposed to favour candidates who best represent the local interests. Still, in the presence of mass media and the de facto pooling of electoral funds in political parties, the plural system favours the strongest electoral committees, i.e. those with the biggest funding and the most efficient electoral staff working on the ground. Plural electoral regimes are characterized by durable partisan structures, with a few strongest political parties holding the key positions, and small parties being pushed aside. Proportional legislative elections are the opposite: votes obtained in each voting district are pooled together for each party (or electoral committee), and each party acquires, in the legislative body, a number of seats proportional to the total share of valid votes on the national scale. When this system occurs in its pure form, legislative mandates are not strictly attached to particular voting districts, and legislators are supposed to represent political orientations rather than geographical constituencies. Purely proportional electoral regimes usually lead to a great number of parties being present in the parliament, and to governments based on coalitions rather than on single parties. Many electoral systems, whilst being essentially proportional, include arithmetical methods (e.g. the d'Hondt method) that aim at reducing excessive fragmentation in the legislative body. In the DPI, they are classified as separate cases, yet they are much closer to proportional regimes than to plural ones, and for the purpose of the present study they are aggregated with the former. With

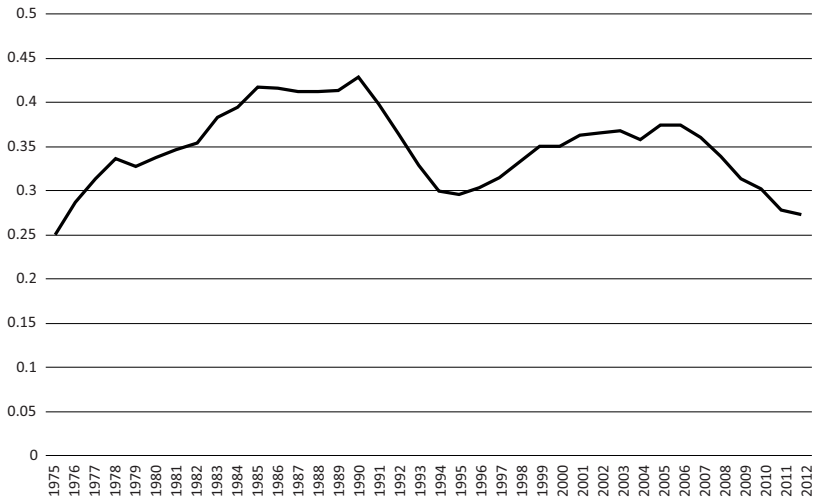

Figure 1. Global average share of votes won by the ruling party or coalition in the latest elections
Source: Database of Political Institutions, the World Bank.

that distinction in mind, the DPI yields an interesting change in proportions. Whilst the total pool of "country-year" observations displays virtual equality in the occurrence of those two regimes, the 1970s were marked by a clear domination of proportional elections (68% of cases vs. 32% of plural elections), the present political systems are much more frequently plural (59%) than proportional (41%). Thus, political systems seem to gravitate towards a growing concentration of political power in the biggest and most influential parties. As the relative position of political parties is in focus, it can be interesting to have a glance at the time trend of a variable called "numvote" in the Database of Political Institutions, representing the share of valid votes cast for the ruling party or coalition in the last legislative election (in the case of coalitions, it is the total of votes cast for all the parties involved). Figure 1 represents the cross-sectional average of that variable from 1975 until 2012. An intriguing cyclical variation emerges: from 1975 until 1990, the ruling parties tended to strengthen their relative position, from an average of 25.1% up to 42.9%; a trough followed when the average fell down to 29.6% in 1995, to go through another cycle with a maximum of 37.4% in 2005–2006, and another downswing afterwards.

Political systems across the world have a tendency to concentrate political power in the ruling parties, yet some kind of entropy occurs from time to time and breaks the coagulation of power. The most logical entropic factor to point at is the relative polarization of ideological stances between parties, which can prevent the forming of large coalitions. The DPI estimates political polarization with two variables, namely POLARIZ and POLARIZ_STRICT. They are compound variables, based partly on competitiveness in the appointment of legislators and executives of the government and partly upon the maximum difference between the chief executive's party value (and the values of the three largest government parties and the largest opposition party). The latter valuation is made on the grounds of the basic distinction of economic programmes into: conservative, Christian democratic, communist, socialist, social democratic and centrist. Polarization is equal to "0" when the democratic competitiveness is below a critical level, when the ruling party does not focus on economic issues or when there is no clear information. Otherwise, and according to doctrinal differences, the variable can take the value of 1 or 2.

In the whole data panel of the DPI, null polarization largely prevails, with 79.3% of all the "country-year" observations; significant polarization ranked at "2" occurs in 15.1% of cases, and moderate polarization estimated at "'1'" is a rare case (5.6%). Over time, the percentage of cases with null polarization progressively recedes, leading to a higher disparity in economic programmes in the average legislative body. The interesting detail to notice about the "POLARIZ" variable is that it measures the ideological distance between parties present in the legislative body, not between all the parties and pressure groups active in the country. The prevalence of "zeros" means that even when there are democratic elections, the economic programmes de facto appointed by the voters are quite close to each other. In other words, the average national democracy seems to swing between economic orientations rather than to balance them. However, this tendency tends to weaken over decades. In 1975, the occurrence of non-null political polarization (1 or 2) was 9.8%, and in 2012 it climbed to 24.8%. We are learning, as a civilization, to balance ideological stances.

That quick overview of the main trends at work in political systems across the world prompts two cautious, general observations. Firstly, constitutional orders show a tendency towards simplification and clear patterning, whilst partisan structures of the body politic slowly gravitate

towards greater complexity. Secondly, as a society, we are only learning how to use the political system in place as a medium to balance divergent ideological stances. It means that, as a civilization, we are at the stage of increasingly intense political bargaining and competition, within relatively predictable constitutional structures.

1.12. Changes in international law

Constitutional states seem to be the necessary middlemen between any form of globally concerted initiatives, e.g. in such fields as climate change or poverty or the actual action at the level of local communities. Since constitutional states sign and ratify international agreements and participate in international organizations, they are supposed to translate the globally formed goals into changes in their respective territories. At this international level of politics, two types of change are to be observed, with some kind of mutual contradiction between them. On the one hand, initiatives like the Paris Framework Climate Agreement suggest that constitutional states should have an increased role in economic and technological changes and, last but not least, should be the prime movers of capital between the developed countries and the developing ones. On the other hand, a new generation of trade agreements is emerging, e.g. the recently signed Trans-Pacific Partnership (TPP) or the Transatlantic Trade and Investment Partnership (TTIP), still in negotiation. Those agreements share a common trait which distinguishes them radically from older ones such as the General Agreement on Tariffs and Trade: they probe very deeply into matters that belong de facto to constitutional law. In those new agreements, one can find regulations that pertain to such vital components of national constitutions as: citizenship, definition of national territory, competences of governments at various levels (i.e. central and local). Whilst older trade agreements focused on what states should or should not do, the trade regulations presently being developed take care of what states and governments actually are. Matters regulated so far by national constitutions become regulated at the international level. This, in turn, means that the geographically dispersed trial-and-error game in the forming of constitutional states progressively turns into the implementation of unified standards. One could say it is a good thing, as those standards seem to be acceptably democratic. Yet, standardization usually puts an end to experimentation. Social structures are

technologies, in the sense that they play a vital role in the efficiency that we, as a species, demonstrate in using limited resources. Social structures, just as commonly understood technologies, need experimentation if they are to progress. The currently observable trends in international law seem to over-standardize constitutional orders and constrain their development.

In 2013, the general public in Europe became increasingly informed about a concept referred to as "TTIP" or the Transatlantic Trade and Investment Partnership. It started quite turbulently, with social activists vehemently protesting against "threats to democracy", and most people did not know what those protests were about. On 12 March 2013, the European Commission released a working document entitled *Impact Assessment Report on the Future of EU-US Trade Relations*. That document, bearing the signature "SWD(2013)68 final", accompanied a recommendation for the Council Decision authorising the opening of negotiations on a comprehensive trade and investment agreement, dubbed the Transatlantic Trade and Investment Partnership, between the European Union and the United States of America. On 17 June, the Council of the European Union declassified and made public a document entitled *Directives for the Negotiation on the Transatlantic Trade and Investment Partnership between the European Union and the United States of America*. In diplomatic language, it is called a "negotiation mandate". When made public, it means: "Now, we have to change the way we have negotiated that agreement up to now. No more covering it up. We need to go public with those negotiations". At the very beginning of the negotiation mandate, the nature and scope of the agreement in question are specified, in three points. Point (1) states that *The Agreement will exclusively contain provisions on trade and trade-related areas applicable between the Parties. The Agreement should confirm that the transatlantic trade and investment partnership is based on common values, including the protection and promotion of human rights and international security*. In politics, if the negotiating Parties need to specify by writing that the agreement being negotiated will refer exclusively to trade, it means that the actual negotiations cover much more than just trade. Clearly, something had been stirring up on both sides of the Atlantic, and the second sentence of point (1) is informative about it. It is publicly claimed that the values are common, which means that a lot of people involved in the negotiations can see a lot of divergence as regards values. That divergence is bound to refer to human rights and international security. By the way, in its simplest

definition "value" is *something important to someone, beyond the current situation*. As we pass to point (2) of the mandate, it becomes even more interesting: *2. The Agreement shall be ambitious, comprehensive, balanced, and fully consistent with World Trade Organisation (WTO) rules and obligations*. Both the Member States of the European Union and the United States are members of the World Trade Organization. If they need to stress publicly that a new trade agreement they are negotiating is fully consistent with WTO procedures, it means there are loads of possible inconsistencies. A report issued by the European Commission on 13 May 2014, co-authored by Professor Richard Parker (University of Connecticut School of Law) and Professor Alberto Alemanno (HEC Paris & NYU School of Law), entitled *Towards Effective Regulatory Cooperation under TTIP: A Comparative Overview of the EU and US Legislative and Regulatory Systems*, gives a very gentle and polite glance at the basic fact that if the United States and the European Union were to come to full agreement about mutual trade, that agreement would actually supplant the WTO, and there is hardly any way around that. The third point of the negotiation mandate leaves little illusion on that point, as it states that *The Agreement shall provide for the reciprocal liberalisation of trade in goods and services as well as rules on trade-related issues, with a high level of ambition going beyond existing WTO commitments*. OK, we are going beyond the WTO. The interesting detail is that the WTO is based on the principle of free trade. The reading of the General Agreement on Tariffs and Trade, being the contractual foundation of the WTO, states that governments should interfere in trade as little as possible, and no intervention at all would be the best solution. How can we possibly go beyond that? What kind of trade is freer than free? Or maybe forced trade is freer than free?

On the other side of the North American continent, a similar stir is observable: the Trans-Pacific Partnership (TPP). The initiative that allegedly emerged from the initiative of United States Trade Representative was being negotiated really slowly as other Pacific ideas emerged, e.g. the Regional Comprehensive Economic Partnership or the Free Trade Area of the Asia Pacific (Petri et al. 2014). The signature of the TPP finally took place on 4 February 2016. The study of the general provisions in the TPP inspires interesting observations. Chapter 1, Section A starts with the declaration that *The Parties, consistent with Article XXIV of GATT 1994 and Article V of GATS, hereby establish a free trade area in accordance with the provisions of this Agreement*. The General Agreement on Tariffs

and Trade (GATT) states that no country should prefer or privilege trade with some specific countries rather than others. One of the most fundamental principles of the GATT is that each member signatory treats all the other members identically in the matters of trade. If the signatories of the TPP establish a zone of free trade between them, it means that trade inside the zone is freer than trade between the members of the zone and the countries outside of it. That breaches the GATT, but the signatories declare being in full accord with it. It is particularly interesting in view of Article 1.2. of the TPP, entitled "Relation to other agreements", which provides that:

1. Recognising the Parties" intention for this Agreement to coexist with their existing international agreements, each Party affirms:
   (a) in relation to existing international agreements to which all Parties are party, including the WTO Agreement, its existing rights and obligations with respect to the other Parties; and
   (b) in relation to existing international agreements to which that Party and at least one other Party are party, its existing rights and obligations with respect to that other Party or Parties, as the case may be.
2. If a Party considers that a provision of this Agreement is inconsistent with a provision of another agreement to which it and at least one other Party are party, on request, the relevant Parties to the other agreement shall consult with a view to reaching a mutually satisfactory solution. This paragraph is without prejudice to a Party's rights and obligations under Chapter 28 (Dispute Settlement).

Article 1.2 stipulates that the Parties affirm something. What does "affirm" mean in a contract? If, as we sign a contract, we "affirm" something, it usually means that we feel entangled in a lot of apparently contradictory obligations, and the contract at hand is just another piece in this already complicated structure. The parties to a contract tend to "affirm" something when they want to have some kind of back-cover in case they had to breach the present contract. As we can see, there is a lot of affirmation at the very beginning of the TPP. There is a whole bunch of international agreements binding for the signatories of the TPP, and when the Emperor puts all that legal clothing on, it just chafes. This is, first of all, about multilateral agreements (point 1_a), and about the bilateral ones, too (point 1_b). Point (2) of Article 1_2, when translated into plain language, says expressly that the signatories of the TPP openly admit to

seeing a perspective of many years spent on disentangling the intricate legal cobweb they are engaged in. Something even more interesting appears in Annex 1-A to the TPP, entitled "Party-Specific Definitions". Those definitions are grouped in the following categories: national territories, central level of government, customs administration or any successor of such customs administration, natural person who has the nationality of a Party, regional level of government and domestic law. Thus, we have an agreement which technically is just about trade and yet it specifies in detail the levels of government in the member countries, the citizenship of those countries and the criteria for recognition of the applicable law. Sounds familiar? To those who do not recognize any pattern here: these are the essential components of national constitutions. In other words, there is a legal text headed "trade agreement", which in its most general principles declares an open interest in regulating constitutional matters. If anyone compares this approach with the language used in the 22-year old GATT, two completely different worlds appear. The GATT treated the signatory members as so fully autonomous that it would be unthinkable to specify, in a trade agreement, the constitutional structure of those countries. Still, the TPP goes much deeper in those matters. Whilst the signature of the GATT was considered more of an international opening, the commentaries on the TPP tend to focus rather on *strengthening the international position of [insert the name of the country in these brackets]* (see for example: Kolsky-Lewis 2011; Petri 2013; Elms 2013; Petri, Plummer 2012).

1.13. Migrations

Things have changed, indeed. Both national political systems and international relations have changed. Trade agreements are no more only about trade: they have become a tool for rearranging the world of politics. Protesting against that phenomenon is one option, of course. Yet, this is a book supposed to give smart insights into matters of life. One smart insight that one can have about any phenomenon in the universe consists in asking "why now?". Why was that TPP agreement not signed 10 years ago, or why not to push it off until ten years from now? What is so special about the period we are living in now? The simplest answer is "because there is a lot of movement in an increasingly crowded space". Table 1 presents compound annual growth rates (CAGR) in two demographic

Table 1. Compound annual growth rates (CAGR) in global population and in the global migrant stock (in %)

Years	CAGR global population	CAGR global migrant stock
1965–1970	2.1	0.8
1971–1975	2.0	1.1
1976–1980	1.8	2.7
1981–1985	1.8	2.3
1986–1990	1.8	9.7
1991–1995	1.6	1.3
1996–2000	1.4	1.5
2000–2005	1.3	1.9
2006–2010	1.2	1.9

Source: World Bank.

aggregates, as available in the databases of the World Bank: global population and the global migrant stock. The World Bank's definition of migrants covers all the people who have been born in a country different from the one they are reported in the national census. As national censuses seldom cover all the immigrants present in a country, that account of migrant stock tends to show the long-run sedimentation of migration processes rather than the people really on the move at the moment. Until 1975, the rate of growth in the migrant stock had been lower than the rate of growth in the population. If the number of people moving grows slower than the number of people present in a space, it means that the velocity of movement decreases. After 1975, a new tendency emerged with a culminating point in 1990: the number of migrants has been growing faster than the overall population. People are moving faster across the globe, and it does not refer to travelling: it refers to full relocation. In 1990, the surplus of growth in migration over the overall demographic growth reached a record high of 7.9 percentage points. It was around 1990 that the Soviet Union, and the Soviet Bloc in general, split into parts. It was the time when the war in Yugoslavia started. It was the time of a short but violent explosion in the financial markets, followed by a financial depression. The first half of the 1990s brought a slowdown to the global

movement of population, but after 1995 the process restarted. By 2010, the migrant stock had been growing much faster than population: the human race keeps moving all over the planet at an increased speed.

After 2010, negotiations in the matter of two huge trade agreements – TTIP and TTP – started. Both were openly commented on as the American step towards stronger international presence. It is hard to trace back the exact starting date, but sometime between 2010 and 2013 seems a plausible assumption. In 2014, Russia invaded Ukraine and took over Crimea. In 2015, a massive wave of migrants flew into the European Union, whilst Russia deployed its forces in the Middle East. In 2016, China deployed its navy in the Philippines, Turkey sent its troops into Syria, and the citizens of the United Kingdom voted for leaving the European Union. Slightly before the so-called "Brexit" poll, the President of the United States of America publicly announced that it was out of the question for his administration to sign the TTIP just with Britain, with the exclusion of other European countries. This was a clear indication that someone made such a proposal. Big boys definitely started making long passes across the whole playground. Since that happened between 2000 and 2010, the speed of movement in the global population significantly increased.

1.14. International aid as an aspect of international relations

International relations in the domain of business and finance can have a deep impact upon national political systems. Two examples seem relevant: international aid and investor-state disputes. Quite a rich body of literature indicates that international financial aid does change the institutions of the recipient countries, which in the jargon of aid is called "capacity building". The outcomes of "capacity building" are seen as the most frequent failure of aid programmes. Still, the problem seems more to concern the way aid is given rather than received. The donors seem to have a systematic problem with walking in the recipients" shoes (see for example: Moss et al. 2006; Knack, Eubank 2009; Barder 2006; Birdsall 2007; Kaufmann 2009). Whilst failing in capacity building, aid is indubitably salutary for the poor (Hirano, Otsubo 2014). The general problem with the donors" impact upon the emergence of institutions in the recipient countries is that the latter, as a rule, do not want that. For example, the growing movement of South-South Development

Cooperation (SSDC) is strongly attached to the argument that aid is often used as a neo-colonial tool by developed countries, imposing unreasonable constraints on developing countries and tying aid to commercial, political and military interests of the donors (Reality of Aid Management Committee 2010). Probably the best example of the gap between the expectations of donors and the actual institutional capacity of the recipients is the process of constitution making in African countries. A number of authors argue that the process has been, so far, largely an attempt to implement, in African societies, institutions fundamentally different from the African tradition. The process can be compared to someone picking up food from an elaborate buffet in which they do not recognize anything really familiar (Seidman 1987). Centralization is an excellent example. Most of the early African constitutions were based on the Western institution of central government legitimated by the nation. Still, pre-colonial African societies worked in a different manner: the bulk of legitimacy was attached to local chiefs of individual villages, whilst any type of central, national government was rather of an ephemeral kind, and nobody truly cared to legitimate it (Ndulo 2001). Thus, principles of centralization that emerge in African countries are, as a matter of fact, a big experiment, which frequently results in an excessive concentration of power in the hands of the otherwise quite unstably legitimated president of the republic. Nigeria, Ethiopia and Zambia are good examples.

Facing the challenge of helping the poor and, at the same time, trying not to hamper the institutional development of the recipient countries, the usual donors" response is to seek an improvement of the policies applied. A fine example of this approach may be found, for example, in Radelet (2004). The present paper proposes a completely different, novel paradigm of aid. For want of a better word, we can call this paradigm "orientation on principles" as opposed to orientation on policies. Aid is a long-lasting, global phenomenon. Using the terms of the systems theory, after Nicklas Luhmann we can assume that aid reached the stage of operational closure already some time ago (Luhmann 1992). Both its accumulated experience and its actual complexity call for a shift from governance based mostly on goal-oriented policies to one grounded in a well-legitimated, normative base.

Capital shapes social structures, and social structures shape capital. Any hierarchical, social structure – states and corporations included – is able to sustain itself over long periods of time if it has both legitimation and economic power. The concept of legitimation, as introduced

here, is basically the same as that used by Max Weber (Weber 1920) and H.L.A. Hart (Hart 1961), but mostly as that developed by Jürgen Habermas (Habermas 1975; 1979; 1996). Society needs stabilization in order to deliver most benefits from association. Social stabilization requires a set of generally recognized rules of conduct. Some of them are formalized as legal rules, whilst other are less formalized moral rules. Generally recognized rules do not emerge randomly. They require a gradual process of social mediation and communication. That process has its roots in language, which serves as a medium for the discursive emergence of legitimate rules. It is worth explaining the link between legitimation and legitimacy. Those two terms are sometimes used interchangeably, yet a nuance should be noticed. Legitimacy is a state of society at a given moment, whilst legitimation is more of a process. Legitimation brings legitimacy, so to say.

As the stream of aid is allocated, distributed and received, many social agents are in a temporary, natural possession of the capital goods that aid represents. Correspondingly, many opportunities for economic power arise. Each of them, besides the economic power in the strict sense, is characterized by a certain legitimation and, consequently, by a certain level of stability. Legitimation of the political system is essentially incremental, i.e. emerging as the result of a long, complex social process, with strong connections to law and morality. In the ideal state, there is an equilibrium between legitimation and economic power, resulting in well-grounded political power. From that state of equilibrium, the political system may drift toward one of the two extremes: legitimation without economic power, or economic power over and above the scope of legitimation. The mechanism of sliding off the equilibrium seems to be attached mostly to the changes in economic power. Legitimation changes slowly, whilst economic power can change faster. One can grasp that difference by comparing the pace at which constitutions change, with that at which consecutive, annual budgets are voted.

Governments are structures, not monoliths. They are structured institutionally and sociologically. The latter is the most interesting at this point. The public sector is a population of people who, in the first place, are merely individuals, with their individual goals and strategies to achieve them. Those individuals associate in more or less formal ways, forming coalitions, lobbies, clubs, parties, etc. Thus, when we talk about the political power of the government, we mean the power held, acquired and exercised by many people. A game-theoretic approach can be used to

model the transformation of individual strategies into collective political action (see for example: Harsanyi 1953; 1966; 1967; 1968). The capital brought by the stream of aid can influence the political system in two basic ways. Firstly, it can enter de facto into the fiscal equation of the public sector, thus increasing its overall economic power. Conversely, aid may remain out of the actual reach of public agents, in the hands of non-governmental organizations (NGO) with strong independence. Yet, those NGOs would also found their social power on the economic power conferred by the natural possession of capital goods, as conveyed by the stream of aid. The point of the argumentation is that any social structure which spends the capital coming from aid has economic power deriving from that capital. The crucial component of the overall social benefits resulting from aid is the actual legitimation combined with that economic power. Given the previously cited body of research, the basic problem (and the basic challenge) is to prevent the development of "feral" economic power, lying outside of the scope of legitimation.

The influence of aid upon the recipient societies depends mostly on its intensity, i.e. on the relative importance of capital provided through aid in proportion to the national income and to the domestic formation of private capital. Among the biggest recipients of aid, only some receive it in amounts sufficient enough to expect any social change at all. India, China, Indonesia, the Philippines – these are only a few examples of a huge absorption of aid accompanied by such a low intensity that expecting any significant change in response would be irrational. Simplifying a little, two distinct cases of aid are to be considered. On the one hand, there are those big, low-intensity recipients where aid does its primary job, that of equalizing social opportunities. On the other hand, there are the high-intensity recipients where aid works as a factor of an overall shift toward a new social order. Those high-intensity cases are usually observed in emergent societies. They are either emergent in the strict sense of the word (e.g. Eritrea), or just profoundly shaken by the recent, historical events (e.g. Iraq). Those societies tend to experiment with the established institutional patterns and create completely new ones. That tendency towards institutional experimentation is well confirmed both by empirical research cited in the introduction and by a somewhat forgotten strand of social theory (Heath 1957; McCallum 1970). The emerging, experimenting societies are those which most frequently receive the label of having an "insufficient capacity building" when it comes to the assessment of results.

The exact role of aid in the recipient society depends mostly on the intensity of aid measured per capita or relatively to the national income. The greater the intensity of aid, the greater the probability that besides its elementary function of alleviating poverty it becomes fully grown capital that is accumulated and serves the economic power. Trying to predict, plan and possibly enforce any kind of social changes more complex than, say, the bare fact of building 20 new schools is irrational as far as the outcomes of aid programmes are concerned. It is impossible to plan, externally, complex institutional changes in emergent, self-experimenting societies which are the recipients of the most intensive aid per capita. One of their greatest institutional challenges is to find a relatively durable and sustainable equilibrium between the slowly changing legitimation and the quickly changing economic power of governments. A successful absorption of foreign institutional patterns might just be an event of the *en passant* type. The more intense the stream of aid per capita, the more likely it is to push the political system out of its precarious balance. Pockets of illegitimate economic power, gone feral and derived from the stream of aid, keep on emerging in those countries. On the other hand, in many areas of public mission, their governments stay economically weak regarding their scope of legitimation.

The situation in which we cannot reliably predict the overall social outcomes of a given policy resembles strongly the veil of ignorance, as defined by John Rawls.[3] Aid, as a global, social phenomenon, has grown old enough to gain its own balance between economic power and legitimation. The key step to take now is to build legitimation. It is once more worth noticing that legitimation is not the same as legitimacy. The proposition to build legitimation for aid does not mean that aid has no legitimacy. Legitimation means that the history of a given social action so far has allowed building a broad normative base. Following H.L.A. Hart (Hart 1961), we can assume that the normative base of aid should consist of both the primary rules of conduct and of the secondary rules of recognition.

So far, aid is policy-oriented, thus mostly utilitarian, which requires predictability. Still, most aid programmes are haunted by something, which for lack of a better word can be called "the paradox of consistent volatility". On the one hand, it is beyond any doubt that aid is a durable, social phenomenon and has a significant place in the recipient

[3] For a more substantial development see: Rawls 1999: 15–19.

societies. On the other hand, any particular aid programme always contains the principle of "sustainable results", which means that the social change brought by aid should be able to live a life of its own as if the aid were to be removed at any moment. Consequently, we have a paradox: we manage a social action undertaken through decades of history as if it were to end tomorrow.

Now, let us pass to a positive description of managing aid on the grounds of John Rawls' theory of justice. The normative base of the primary rules should rest, of course, on the two principles of justice as Rawls defined them. For the sake of theoretical completeness, let us remind them. The first principle states that each person is to have an equal right to the most extensive scheme of equal basic liberties compatible with a similar scheme of liberties for others. The second principle is the following: social and economic inequalities are to be arranged so that they are both reasonably expected to be to everyone's advantage and attached to positions and offices open to all. The complete theory of justice assumes the lexical order of those principles, so that the second one has any relevance only insofar as the first principle is satisfied. Yet, the problem that we want to address is that many, if not most of aid programmes, have to operate in a political environment that does not fully comply with the first principle. Aid is focused on distributive justice as encompassed by the second principle, yet it cannot make the whole recipient society more just. Justice is to be sought and found in the very way of donating and distributing aid. The main, long-term goal is to gain durable, sustainable legitimation for aid as a global project.

John Rawls was not really explicit on the practical ways of implementing his theory and on defining the secondary rules of recognition for actual institutions. As for that aspect, the works of Ronald Dworkin, more precisely his critique of the utilitarian approach to law, provide really useful guidelines (see for example: Dworkin 1975; 1980). The key recommendations to borrow from Dworkin's approach are the following: put principles before goals, construct principles into institutions, establish those institutions in a way that allows adjudicating hard cases independently of the policy setting.

Thus, the most important step to take is to use the known history of aid over the last six decades in order to identify the typical conflicts of interests that arise in connection to aid, and construe a consistent set of rules, possibly recognized as binding rules of international law, to solve those conflicts. The core idea is that, although we cannot remove the paradox of consistent volatility from aid, we should use the quite abundant

history of aid as a source of inspiration for the future. The typical field of regulation for such rules would probably be the issue known today as "capacity building". The donors expect the institutional changes to go in some definite direction, whilst the recipient country changes in another, divergent direction. Is it fair? Is it just? Should it provide the grounds for stopping the flow of aid or reducing it significantly? Today, such conflicts are set at the level of policy making. With all the due respect for the policy makers, the problem is that of a snake biting its tail, over and over again. The policy makers keep on returning to the same starting point in planning institutional changes in the recipient countries, with a very limited capacity to learn from mistakes. Adjudication, separate and independent from policy making, is probably the best, institutionalized way to learn from past conflicts and past mistakes. Thus, an international arbitration body could be created to settle disputes that arise on the grounds of conflicting interests in aid programmes. That would create a completely different, institutional setting. First of all, it would allow for the existence of legal claims concerning aid in the global population of donors and recipients. Such an international arbitration could settle, for example, conflicts of interests between NGOs and governments, in the recipient countries, as for the actual control over the stream of aid. Similarly, conflicts arising from overlapping aid programmes could be settled through such international arbitration. There is strong evidence that international arbitration can contribute to building new institutions. The controversial area of investor-state dispute settlement is an example of new norms forming through adjudication (Nottage 2006; Bjorklund 2009; Schill 2011). Someone could say: "Lawyers again? No, thanks!" Of course, creating a new system of international arbitration would create much controversy at the beginning. All international courts did, actually. Yet, the main argument should be brought forth once more: aid, as a global activity, needs to be globally recognized, and the only way to create such a legitimation is to learn consistently from the past experience and to communicate that lesson in a consistent manner.

1.15. Investor-state disputes and international law

As international relations and their business ramifications come into view, one institution is viewed as particularly controversial, that of investor-state disputes. The investor-state dispute settlement (ISDS), which we define as an

institution of international arbitration between private investors and their host states, treated as equals, is one of the main concerns on the part of various anti-corporatist movements. That general concern, expressed widely in mass media, also finds its reflection in scientific, mostly legal research (see for example: Guzman 1997–1998; Coe 2006; Burke-White 2008; van Aaken 2008). The main lines of criticism include: lack of transparency, dubious impartiality of the arbiters, systematic enforcement of corporate claims against legitimate governments, and a clear asymmetry to the detriment of developing countries. In Europe, that issue is currently associated with a significant, institutional change to come, namely the Transatlantic Trade and Investment Partnership, or TTIP. In Europe, the TTIP is likely to bring about the most dramatic liberalization of trade and investment flows since the creation of the European Union. It gives rise to a growing concern about the possible imbalance in the economic power between the American corporations and the European governments. The TTIP is likely to adopt the already classical pattern of protection for the investors, with international arbitration among the main procedural rights.

The very institution of investor-state dispute settlement, on the grounds of international treaties, is not quite new. First, let us trace the broad context. Since the 1960s, and maybe even earlier, foreign direct investment has been a major factor of economic development. Governments have developed a whole range of institutional tools to attract foreign investors. "Institutional" means that, besides incidental actions (e.g. occasional privatization), more durable patterns of public policies (e.g. legal rules) have emerged. International treaties are among the most salient examples of institutional changes directed specifically towards attracting foreign investors. The typical, legal construct that governments use comprises a certain number of bilateral investment treaties (BIT), which, in turn, refer to a set of rules contained in multilateral treaties. In order to encourage foreign investors, governments give them legal guarantees, or rights, both substantive and procedural. The Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention or the Convention), dating back to 1966, seems to be an institutional milestone for the ISDS. Around that time, and after, both bilateral and multilateral commercial treaties used to encompass a typical set of rights that governments guarantee to private foreign investors. Those rights are both substantive and procedural. Their general principle is that of treatment no less favourable, from the point of view of the private investor, than the treatment available

under international law (Guzman 1998; Franck 2008). The procedural rights cover the possibility of having recourse to international arbitration between the government and the private investor, should all the national legal means be exhausted. A good example here is Article 9 of the Georgia / Greece Bilateral Investment Treaty:

ARTICLE 9

Settlement of Disputes between an Investor and a Contracting Party

1. Disputes between an investor of a Contracting Party and the other Contracting Party concerning an obligation of the latter under this Agreement, in relation to an investment of the former, shall, if possible, be settled by the disputing parties in an amicable way.
2. If such disputes cannot be settled within six months from the date either party requested amicable settlement, the investor concerned may submit the dispute either to the competent courts of the Contracting Party in the territory of which the investment has been made or to international arbitration.
   Each Contracting Party hereby consents to the submission of such dispute to international arbitration.
3. Where the dispute is referred to international arbitration the Investor concerned may submit the dispute either to:
   a) the International Centre for the Settlement of Investment Disputes, established under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, opened for signature at Washington D.C. on 18 March 1965, for arbitration or c[o]nciliation, or
   b) an ad hoc arbitral tribunal to be established under the arbitration rules of the United Nations Commission on International Trade Law (U.N.C.I.T.R.A.L.).
4. The arbitral tribunal shall decide the dispute in accordance with the provisions of this Agreement and the applicable rules and principles of international law. The awards of arbitration shall be final and binding on both parties to the dispute. Each Contracting Party shall carry out without delay any such award and such award shall be enforced in accordance with domestic law.
5. During arbitration proceedings or the enforcement of the award, the Contracting Party involved in the dispute shall not raise

the objection that the investor of the other Contracting Party has received compensation under an Insurance contract in respect of all or part of the damage.

If a social phenomenon is growing in importance, like the one presently discussed, there has to be some kind of logic to that. In other words, merely claiming that the growth of the ISDS is a threat to democracy, and thereby implicitly treating the phenomenon at hand as random, or conspiracy-based, seems irrational. There probably is an underlying social change, and the presently growing wave of ISDSs is very much likely to be a symptom of what legal scholars call "system building" (Nottage 2006; Bjorklund 2009; Schill 2011). One should keep in mind that the ISDS is closely linked to two, quite new social phenomena. On the one hand, since the 1950s, we have been witnessing a steady growth of both foreign direct investment and financial markets as a whole. On the other hand, the combination of post-colonial and post-communist geopolitical changes gave rise to the emergence of new countries, mostly developing ones, with some having already entered, or entering, the category of emerging markets. Those new countries became the recipients of significant foreign investment, which was accompanied by the corresponding, both qualitative and quantitative development of financial markets. A completely new economic structure has thus emerged and still calls for relevant legal regulations. In the overall dynamics of the signed BITs, two waves are to be noticed: the big, post-colonial one in the 1960s and 1970s, followed by a second, slightly smaller, post-communist one at the beginning of the 1990s. Both waves had a common denominator: the legitimacy of the newly emerged governments was significantly broader than their actual economic power. What those governments desperately needed was capital, to consolidate their political power. On the other hand, both waves corresponded to a significant change in the global economic landscape. The 1970s brought both liberalization of financial markets and the first, significant economic shock after the Second World War, the oil crisis. Both factors contributed to the awakening of the investors" interest in the assets located in the newly emerging, developing countries. Another financial crisis, and the resultant reshuffling of financial markets, characterized the early 1990s. Once more, new directions of foreign investment, that is the emerging, post-communist countries, attracted the attention of private capital. Thus, each wave of new BITs

signed corresponded to a wave of structural change in the global, capital market. The factor of time is of paramount importance here. Most legal institutions that make up the foundations of the current social order are centuries old, with some of them, such as the basic rules of civil law, deriving their intellectual content from the tradition of Ancient Rome. In the light of that legal tradition, the completely new challenges of international commercial law are barely a blink. Legal rules take time to adapt.

Susan D. Franck, in two consecutive papers (Franck 2008; 2009) brought an interesting, quantitative insight into the observable patterns in both the initiation of investor-state disputes and their resolution. A majority of claims come from the US nationals and, in general, from those coming from the developed countries. Conversely, the defendant governments are often those of developing countries, yet they are the relatively wealthier ones, not the strictly speaking Low Income countries. Among the several hundred of bilateral investment treaties in force, only a few dozen seem to regularly give a rise to investor-state disputes, especially the NAFTA treaty, as well as the US–Argentina bilateral one. Despite the criticism of the impartiality of arbiters appointed by international organizations, institutionalized arbitration and, more specifically, arbitration under the auspices of the ICSID (International Centre for the Settlement of Investment Disputes) seems to prevail substantially over ad hoc arbitration tribunals. Less than 40% of disputes seem to end up with the investor winning, and almost 60% of cases lead to the legal victory of the sued government. The settled cases (i.e. with no award for any of the parties, and without legal victory for any of them) are rare and far between. Investors seem to be much more successful in the jurisdictional phase, whilst governments tend to win more frequently in the merits" phase. In the damages" phase, results are mixed. As a rule, the damages actually awarded to private investors are several times lower than their claims, with two cents awarded on average for every dollar claimed. A significant majority of ISDS claims are related to businesses in the energy sector and infrastructural services (e.g. water supply).

Both Susan D. Franck's research and the recent data published by UNCTAD (UNCTAD 2013) suggest a rapidly growing number of investor-state disputes. In 2012, 58 new treaty-based disputes were initiated, the highest number ever. In order to assess whether that recent surge in ISDSs predicts the advent of "the corporate world", one should keep in mind the basic rule of research: as the ISDS is treaty-based, one should study both the ISDS as such and the treaties that the ISDS is based

on. International cooperation in the broad sense is regulated by about 50,000 treaties, mostly bilateral, registered with the United Nations. Only about half of them have any provisions governing the resolution of disputes. Strong empirical evidence suggests that external delegation (i.e. delegation of dispute resolution to external legal bodies such as arbitration tribunals) is used as a legal device whenever the signatory governments face significant uncertainty. Such uncertainty regards both the state of the world in general and the way in which a given field of international cooperation is expected to develop (Koremenos et al. 2001; Koremenos, Snidal 2003; Koremenos 2007).

Any hierarchical, social structure – states and corporations included – is able to sustain itself over long periods of time if it has both legitimation and economic power. Legitimation is defined both qualitatively and quantitatively. On the one hand, it is a set of basic rights and a set of actions to which the government is entitled. On the other hand, the qualitative scope of legitimation can be translated into a kind of a quantitative index. Legitimation is embedded both in the past communicative, political actions (Habermas 1975; 1979; 1996) and in the actual, normative quality of the social order in place (Rawls 1999). Economic power is grounded in the actual control over the flows and balances of capital, both financial and physical. That definition of economic power is mostly based upon the agency theory, proposed by the new institutional school in economics and created essentially to explain the behaviour of corporations (see: Berle, Means 1932; Wilson 1968; Berhold 1971; 1973; Jensen, Meckling 1976; Fama, Jensen 1983).

Legitimation changes slowly, at the pace of the legal change, which can take hundreds of years in some cases, and decades at best. Conversely, economic power changes quickly, sometimes within weeks. Governments can acquire or lose economic power significantly faster than they can change the scope of their legitimacy, as the former is very much in the swift hands of the executive power, whilst the latter depends mostly on the much steadier actions of the legislative and judiciary branches. A government with legitimation exceeding its real economic power can acquire capital in three possible ways. It can forcefully take the possession of some assets, by its sovereign decision, within the limits allowed by legitimation, of course. Let us call it "sovereign acquisition". The imposition of taxes is a classical example here, whilst the nationalization of property rights is a more drastic one. The second possible path is public borrowing, whilst privatization of assets is the third one. Those three forms

of increasing economic power confer, onto the government, economic power of uneven quality, so to say. They have their mutual dynamics, too. The greater the gap between legitimation and economic power and, consequently, the lesser the government's real political power, the lesser the capacity for sovereign acquisition. If we do not have money to pay the wages of qualified clerks, we cannot hope to impose truly collectable taxes. The lesser the capacity for sovereign acquisition, the lesser the capacity for public borrowing: money is lent mostly to those who can pay it back with interest, that is those who can efficiently impose and collect taxes. Those whose ability to do so is doubtful have significantly harder access to debt. If the gap between legitimation and economic power is really wide, sovereign acquisition and public borrowing represent rather limited ways to reduce it. Privatization is frequently the name of the game in such situations.

Sovereign acquisition may increase the scope of legitimation, just as public borrowing. With increasing tax revenues and a good borrowing capacity, the government may claim some fields of social cooperation, for example through systematic public procurement, as is the case in the healthcare sector. Conversely, privatization is likely to sever some fields of social action from the scope of the government's legitimation.[4] Thus, if we have a government in real need of economic power with quite a broad legitimation, yet poor in capital, a political time bomb starts ticking. Privatization is likely to become massive and irrational in terms of the price at which assets are transferred to the private sector. The price is to be understood broadly, not only as the lump sum of money paid by the private acquirer, but as the total balance of mutual obligations on the part of both the government and the private investor. Politically forced, hasty privatization leads to bad deals, which ultimately brings pressure on both the scope of legitimation and the size of the economic power held by the government. Finally, the government comes to a point where further loss of legitimation, inclusive of further privatization, can lead it not to be a government anymore, and possibly to the disintegration of the state itself (e.g. Sudan). At this point, two alternative scenarios arise: entrenchment or reclaiming. The government can lock itself

[4] The course of social changes in Central and Eastern Europe is a good example of the latter mechanism. Massive privatization at the beginning of the 1990s seems to have permanently removed most fields of doing business from the scope of legitimation of the previously omnipresent governments.

in that quite unimpressive ivory tower of residual sovereignty and accept the position of barely a player among other players. On the other hand, the government may attempt to reclaim some of the previously privatized assets. Reclaiming in this case is a broad concept, covering both the property rights as such and the obligatory rights connected to some assets. The strategy of entrenchment is that of a weak government which actually cannot fully enforce the rule of law, hence cannot properly protect property rights. Some investors may be expropriated or otherwise disadvantaged to the benefit of others, the tougher, smarter and more influential. Yet, the government in place, weak as it is, provides at least a simulacrum of legality to those unfair private deals. Should the reclaiming strategy dominate in public policy, the government is bound to take steps that put a clear halt to the amount of profits that can be made in connection with the previously privatized assets. Anyway, some private investors are hurt, and some others arise.

Both the recent surge in the number of investor-state disputes and the specific quantitative pattern of these disputes are the delayed outcome of forceful, frequently irrationally quick privatization which was supposed to support the frail political position of the newly emerging, post-colonial and post-communist governments with additional capital. Investor-state disputes seem to result mostly from either the local struggles for power between private investors, poorly legitimized by the local governments, or from active attempts, on the part of such local governments to regain the right to dispose of at least some of the previously privatized assets.

In the realm of investor-state disputes, the cases against Argentina as the defendant are practically a separate category. Both the sheer number of cases (more than 40) and their saliently repetitive characteristics make them a textbook-like example. In the early 1990s, the government of Argentina carried out extensive privatization in many sectors of the economy, energy and infrastructure included. The admission of foreign investors and extensive foreign indebtedness of the government allowed the country as a whole to perform a civilizational leap forward. The so-called Convertibility Plan of 1991 pegged the Argentinian peso to the US dollar, which, combined with the privatization, created a unique opportunity for foreign investors: assets were much cheaper than in the developed countries, but the dollarized internal market almost guaranteed high returns on investment (see for example: Sturzenegger, Zettelmeyer 2006). Some 10 years later, around 2000, a combination of external shocks

and bad economic policy triggered a deep economic crisis and huge political instability. While addressing those exceptional circumstances, the government in place took several steps aiming both at giving a new kick to the sluggish economic growth and at calming down social unrest. One of the steps was the so-called "pesification" of the economy (i.e. withdrawal from the parity to US dollar) and in freezing, temporarily, the prices of basic goods. Only then did the authorities realize how extensive the rights that their predecessors had granted to foreign investors were, and how brutal the reduction of those rights was necessary to implement the strategy designed to cope with the economic crisis. Some experts firmly claim that the steps taken were justified by the exceptional circumstances and remained within the limits of a reasonably understood, public sovereignty (see for example: Burke-White 2008). Yet, an avalanche of disputes ensued, some of them leading to international arbitration. The arbitration tribunals, whilst keeping quite a distanced position as to the specific claims for damages on the part of particular claimants, kept a noticeably uniform line of thinking regarding the conflict between the private rights of the investors and public sovereignty. That line of thinking generally resulted in adjudicating the merits in favour of the claimants. One illustrative case is that of *Sempra Energy International (Claimant) vs Argentine Republic (Respondent state)*, brought before the International Centre for Settlement of Investment Disputes (ICSID Case no. ARB/02/16). The privatization of the gas transportation and distribution facilities that took place in Argentina between 1989 and 1992, in some cases extending beyond 1996, went as far as to guarantee to foreign investors non-decreasing, real selling prices to their customers. In the course of the arbitration, the temporal horizon of these guarantees came into discussion, and the Claimant brought forth a very strong argument that the guarantee of prices was, in fact, everlasting (!). No government can reasonably guarantee to a private investor, especially in the field of basic utility supplies, an ever-lasting margin of profitability. It is a breach to the basic logic of market economy. As assessed from today's point of view, such a guarantee is at the limit of economic sanity, thus at the limit of the government's rational legitimacy, yet it was effectively granted at the beginning of the 1990s. The actual revolt against that mechanism of non-decreasing profits started in the judiciary field of the Argentinian state, with court injunctions (Judicial injunction of August 2000 [Resolution 3480/00]), and later took the form of policies at the governmental level. The arbitration tribunal, under the auspices

of the International Centre for Settlement of Investment Disputes (ICSID), had a hard case there. On the one hand, the economic common sense vigorously revolts against the ever-lasting profit margins as contrary to the logic of competitive markets. On the other hand, any tribunal has to apply law in the first place. in this case, both general regulations and individual contracts strongly advocated in favour of those guaranteed prices. The final award attempted to be equitable by adjudicating merits mostly in favour of the claimant, yet reducing the awarded damages to the strict minimum possible. Professor William Burke-White, for example (Burke-White 2008), expressed a very strong view that this, as well as other awards adjudicated by the arbitration tribunals under the auspices of the ICSID, tend to violate the sovereignty of the Argentine Republic. The author of the present book argues that the breach of sovereignty took place many years earlier, when those incredibly unfavourable contracts were signed, with the corresponding general regulations being enacted. Moreover, that breach of sovereignty was not the work of any international arbiter, but of the same Argentinian government that carried out the massive privatization at the beginning of the 1990s. Later on, successive Argentinian governments tried to reclaim that lost legitimacy and, on the whole, they have been quite successful. The decisions of the ICSID tribunals, with significant merits awarded to various private claimants and the actual damages reduced to minimum, have created a path of accomplished facts, through which the Argentinian state is progressively reclaiming the assets previously lost.

Argentine is a category in itself and, in a general manner, illustrates the case of active reclaiming by the government of the previously lost sovereignty, following reckless privatization. Now, let us turn our attention to cases that enter into the "entrenchment" type of behaviour on the part of the government. An illustrative case is that of Ioannis Kardassopoulos and Ron Fuchs as claimants, against the Republic of Georgia as the respondent state (ICSID Case No. ARB/05/18 and No. QRB/07/15). This is maybe an even more striking example of the lengths to which an emerging government can go in order to acquire at least some economic power. In 1991 and 1992, the newly created Republic of Georgia struggled for both international recognition and at least a minimum of internal coherence. At that very moment, the claimants managed to sign, with the government of the young republic, an incredibly advantageous contract granting them, with a truly minute financial involvement on their part, the actual monopoly on the exploitation and exportation of the domestic

resources of oil and natural gas. From today's perspective, the contract was something of a miraculous deal for the claimants; so miraculous that in normal, political circumstances no company, even among the biggest players (such as BP or Shell) could dream about anything even remotely close to the terms of that contract. A witness statement, heard during the arbitration, is particularly illustrative for the circumstances in which the contract was signed. The statement in question is that of Mr. Nanikashvili, a Georgian-born businessman living in Israel, who described the situation in the newly independent Georgia. For the sake of keeping the factual strength of the testimony, it is reported literally below:

> After Soviet Union split, it appear vacuum in the system of the fuel and energy, because every country, they own Transneft, they own oil field, and before everything was concentrate in the centre: export in the centre, budget from the centre, everything from the centre. And suddenly there is no centre, you are alone. So they don't have any contract, and this was the beginning; because of this, there was need for foreign investors there. This was the beginning, either way they cannot work. I tell you one more thing, very important. Please, it's important. Even big companies like Lukoil, when they appear, they don't know how to open a letter of credit. Only the – it was vacuum, you must understand. I'm not saying they are dangerous in the country, it really was financial vacuum: no banks giving, no banks contact. So they really need. It's not because they were stupid, no, they were very clever people, but they need to begin. Even me when I begin to learn, someone teach me this business. I do no learn myself.

As the Georgian political structure acquired more of a standing, successive governments took steps to withdraw from the contract with the claimants. Finally, using the procedural faults which had really taken place at the moment of starting the claimants" operations in Georgia, the government annulled the core component, namely the Deed of Concession granting access to the local mineral resources and the corresponding infrastructure. Yet, at the difference of the Argentinian cases, here the government did not really reclaim the privatized assets as such; what took place was rather the legitimation, by the government, of other private entities taking the business out of the claimants" hands. A similar situation, i.e. an example of the entrenchment strategy on the part of the government, took place in the case of *OKO Pannki OYJ, VTB Bank AG and Sampo Bank PLC vs the Republic of Estonia* (ICSID Case. No. ARB/04/6). Here, we have a privatized fishing company whose assets were transferred to the private

investor without the debts that had burdened them before the privatization. This is a classical case of the government voluntarily entrenching itself in quite a narrow scope of political power and endorsing the liabilities which should have been paid by the private investor.

As one considers the case of *Europe Cement Investment & Trade (Claimant) vs. the Republic of Turkey (Respondent state*) (ICSID Case No. ARB(AF)/07/2), we look at a stable democracy, Turkey, with public sovereignty resting on a relatively well-balanced equilibrium between legitimation and economic power. The capacity of the government for both sovereign acquisition and public borrowing is both noticeable and sustainable. In such a case, when facing such a stable state, private investors have little possibility to acquire public assets in a way that could seriously threaten public sovereignty. Moreover, there are actual cases of investor-state disputes which demonstrate that even a relatively frail democracy can adopt a relatively sound policy for treating private investors. With enough consideration concerning the negotiation of contracts and their implementation, a newly established government can attract private investors and keep the winning hand in the possible investor-state disputes. Lebanon is a good example, with the highly illustrative case of *Toto Construzioni Generali (Claimant) vs. the Republic of Lebanon (Respondent* state) (ICSID Case No. ARB/07/12).

A cursory overview of just some issues of actuality, tackled above, suggests a strong linkage between international law, politics and international capital flows. As international treaties are being renegotiated right now, we should expect deep structural changes in the political systems all over the world. Corporate social responsibility does not really seem important in that respect. Whether big, transnational corporations are responsible or irresponsible in their strategies or not, the key factor of public sovereignty vis-à-vis those strategies is a proper balance between legitimation and economic power of the governments in place. In political terms, this means the balance of powers and of efficiency, between the legislative and the executive branches of the government. Especially a weak legislative, coexisting with a highly efficient and autonomous executive branch, can create dangerous disproportions between legitimation and economic power. In the general case of European governments, the most likely thing to happen is the Ali Baba syndrome. If the executive branch is in the actual possession of valuable assets, with the legislative lagging behind as regards sovereign supervision, abusive transfers of property rights may take place. That, in turn, can ultimately lead to lost disputes against private investors.

1.16. A tentative conclusion: political systems seen as technologies with a lifecycle based on efficiency

A cursory review of the theory brings us back to the essential theoretical question of this book, namely: "To what extent can we consider the constitutional state and its political system as a technology and, if so, what are the practical consequences?". Two alternative views can be formulated in that respect. Firstly, political systems, inclusive of constitutional states, are social structures, i.e. something that determines its own function. Secondly, the history of political systems suggests that they are quite a rational, collective response of large social groups to environmental and economic challenges. In very plain words, political systems both do something to us, and do something for us. If we consider the main technologies we currently use, e.g. railroads, telecommunications, energy supply, interesting analogies to political systems appear. Technologies are technically functional for us, and yet, on a day-to-day basis, technologies we use impose clear boundaries on us. Those boundaries pertain to the way we change our technologies, too. Technological innovation we are implementing at a given moment is very strongly determined by the technological framework that innovation is based on. On the other hand, some features of political systems were breakthrough innovations at a certain moment in time, e.g. universal tax on the current income.

The tentative path, for further exploration, consists in studying the transformations of political systems as we would consider technological change, i.e. in terms of a **lifecycle** connected to the relative efficiency of political systems in delivering the outcomes they are supposed to deliver. The concept of a lifecycle is central to further research presented in this book: we expect constitutional states to change their functioning as their current institutional setting displays changing efficiency.

If political systems are technologies and they change in a lifecycle, three further questions are to be settled, namely: what kind of outcomes are constitutional states supposed to deliver, what is the process of delivering those outcomes, and how can we measure the efficiency of the process? As for the outcomes, **the known facts about the history of constitutional states suggest that their basic social function is to ensure sufficient social stability for adapting the life of large social groups to the basic environmental challenges, the latter being understood in terms of food and energy supply**. Social stability is achieved through three basic mechanisms: delimiting a stable territory, handling social

conflicts using a system of rules developed by reflection, and channelling the capital. We are territorial beings. Sedentary (i.e. non-nomadic) existence within predictable geographical boundaries is one of the most fundamental conditions for social development of any human community. So far, constitutional states have been the best known response to that need. The slow passage from tribal territories, through feuds, to the constitutional state indicates that fixed territories can be managed with varying efficiency, depending on the natural and social context. Among all the territorial forms of governance, constitutional states seem to offer the best balance between territorial stability on the one hand, and flexibility in allowing people in and out of the territory, on the other.

As people live sedentarily and their society prospers, the density of the population inevitably grows. This, in turn, creates new challenges in the form of social conflicts to be handled. Deliberative, social rituals based on communication seem to be more efficient in that respect than the sheer use of force. Whilst Max Weber associated the state mostly with the exclusive prerogative to use coercive force, another theoretical path, represented by Jürgen Habermas, indicates that the very stability of constitutional states depends on their capacity to ensure deliberative ways of figuring out the best policies for all. Similar are the views of Herbert Hart on the nature of law and his claim that, prior to enforcing the law, the core function of the state is to provide the clear rules as to what the law is. Since policies and laws are considered the common deliberative space of society, a logical order appears: from the most fundamental, abstract and general, legal rules, through more and more individualized rules, up to the point when we collectively form rules as to what to do with the tax money over the year to come. One of the main characteristics of any constitutional state is to ensure coherence between the different levels of rules. It can be noticed that, in practice, this coherence is rarely achieved in 100%: this is the point where the presently known pattern of the constitutional state seems to reach the limit of efficiency.

Governments need capital to finance their actions, both to guarantee the continuity of their administrative structures and to implement specific policies. The legitimation of political power, acquired through the deliberative processes of the political system, needs to be balanced with the economic power of actually getting things done. This seems to be the gap in the classical theory of the state as formulated by Max Weber. While Weber explained how the administrative structures control a territory, he did not really explain how those structures attract people to work

in them. Newer views, e.g. those of Barry Weingast, convincingly show that any administrative structure needs a system of pecuniary rewards for its middle management. Administrations need to appropriate capital in order to reward their members for the actual implementation of both the law and of the temporary policies.

That governments have power is a plain fact. Still, how much power do they really have and how can they use it to change the present situation? Can governments change the direction that global capitalism is taking and help to face global natural threats? In order to answer those questions, first we should define the notions of interest to us. What is government? How does it work? When we talk about governments, one of the first associations is that of "people with political power". Governments are nests of that special type of social influence that we call political power, or the power of the State. Political power has two pillars: economic power and legitimation. Economic power means that the government has enough capital to carry out its actions. Legitimation is the empowerment of governments, by a part of their citizenry, to carry out of certain actions. In that respect, there is little difference between governments and corporate structures. In both cases, a relatively narrow elite has been given prerogatives to organize collective action and the financial means in order to actually exercise those prerogatives. As we look more closely at typical constitutional orders, one of the main prerogatives that appears in all of them is that of prolonging their own existence. National governments are essentially endowed with legitimation to sustain their own political structures. Governments can legally organize elections that serve to elect subsequent governments. They can collect taxes and borrow money in order to cover the costs of their own activity. Governments can organize the process of change in the constitutional order, hence they are endowed with the capacity to change the rules they play by. Any existing government is traceable back in time to a point where such elementary prerogatives were established – the point of constituency. Starting from there, political systems may take different paths. They can drift towards strict authoritarianism and block the possibility to change the prerogatives invested in the state to any non-governmental actors. They can develop democratic institutions which regulate the way in which non-political actors can systematically check and correct the legitimation of the government. Finally, various mixes of authoritarianism and democracy are possible and frequently interesting to uncover in their intricate combinations. An important point is to note, as this stage of our

investigation, that the formal rules of constituency seem to matter very little for the path taken by the political system. Technically, Cuba is a democracy, just as Kazakhstan or Belarus. In the past, all the communist countries were technically perfect democracies. Yet, all these cases are de facto examples of authoritarianism. On the other hand, the United Kingdom, Belgium or Spain are technically monarchies, thus apparently they were constituted as authoritarian systems and yet, they are true democracies. Thus, what governments can actually do – or the real scope of their power – is to be considered as a recurrent process rather than a fixed constitutional order.

As we define the scope of what governments can do, it is useful to assess dialectically what they cannot do. First of all, governments cannot make us happy. Quite plainly, political systems encounter clear limits in their impact upon individual attitudes. Certainly, governments can make our lives hard or comfortable, they can indoctrinate us and still they cannot reach to the very bottom of individual human behaviour. This general statement sounds very philosophical but it has a practical side: there are clear limits to the level of social detail that political systems can handle. States are made for big issues rather than for fine details. When they do big things, they can be amazingly efficient. Building a railroad across a desert is something that usually only governments can successfully carry out. Regulating the way in which the land along that railroad should be used can also be comprised by the prerogatives of governments, although at this point inefficiencies appear: a very detailed regulation of architectonic structures can easily turn into a farce. One step lower in the social detail, into individuals" daily existence, and political systems appear as an intruder rather than an agent of social advancement. Governments are limited in their capacity to coordinate very minute details of social life.

Secondly, governments can never dissolve themselves completely, which was already noticed by John Locke. When a government steps down, there are rules for the appointment of the next government. When the constitutional order changes fundamentally, e.g. when a radically new constitution is voted and enacted, a transitory political structure, appointed by the previous structure, handles the process of change. Of course, the history knows many cases of a complete destruction of the political structures of a country, but these always take place as a result of wars or popular revolutions, precipitated by the forces exogenous to the political system itself. Political systems are essentially self-sustainable. Any peaceful, systemic change in politics requires such new rules which both

produce new outcomes for the non-political agents and assure essential survival of the state's administrative structure, to be introduced into the system.

The two attributes of the state mentioned above, namely the limitations in handling social detail and an essential propensity for self-sustainability, combine to form the third important characteristic: governments are very limited in their real capacity to produce and supply goods. The former communist countries provided a textbook example in that respect. Whilst at the beginning of communism, centrally planned economy seemed to be a rocket aiming for progress, it quickly lost its momentum. When it came to coordinating the detailed workings of the markets for products, distortions and absurdities appeared. That failure in economic coordination caused some regimes to fail utterly and pushed some others (e.g. China or Vietnam) to delegate some of their prerogatives to the private sector. The economies of the developed countries also supply interesting examples of such failures to manage production. Healthcare systems can also serve as an example. Most public healthcare systems can provide for efficient vaccination and life-saving surgeries, but they fail to provide the fully required dental care. There is something in stomatology that excludes it partially from the scope of the pooled funding and public medical assistance available to citizens.

Thus, governments can be agents of positive social change to the extent that the change in question: a) can be smoothly combined with the self-preservation of political structures, b) consists in large projects rather than in detailed day-to-day governance, especially in the product markets. This preliminary sketch leads to a more profound insight into the interaction between capitalism and political power. Governments derive their economic power from their capacity to include capitalistic processes into their self-preserving mechanisms, and a separate ability to move large amounts of capital across the social system faster than purely capitalistic processes can do. Both aspects are important and both deserve some development.

Public legitimation granted to governments is true legitimation as long as it remains in correspondence with the actual economic power represented by fiscal flows. If the government is constitutionally entitled to do something that it actually does not do due to the lack of sufficient financial means, that particular field of political legitimation fades and dies a natural death. Sooner or later, those neglected public functions are taken over by the private sector, both *de facto* and *de jure*. If, on the other

hand, the government as a whole or a particular political player holds capital balances that are not clearly and unequivocally attached to any constitutionally defined public purpose, the phenomenon of feral politics develops: politicians start executing discretionary powers beyond the scope of their legitimation. That holding of unemployed capital takes many forms and does not necessarily mean the possession of illegally appropriated money. If, for example, a minister is granted financial appropriation for the whole fiscal year and has the freedom to decide when exactly to spend the money, it can be beneficial to the minister in question to juggle with the timing of expenses. The sum of one hundred million dollars that I hold today has a much greater economic value if I have to spend it in eleven months, as compared to a situation when I have to spend it during the six weeks to come.

The general theoretical approach developed above is exemplified by healthcare systems. Healthcare is one of the basic missions we expect a government to carry out and, at the same time, public healthcare always involves three important components: aggregation of resources, control over important capital balances and effective technological progress in very basic matters of everyday life. Depending on the national culture, citizens expect various scopes of public healthcare, yet no state can claim not to be responsible for the elementary matters of public health. The World Health Report issued by the World Health Organization in 2010 announced that a significant part of healthcare expenditures in the world – between 20% and 40%, depending on the country – does not contribute to deliver proper healthcare as such. These are expenditures ascribed to healthcare understood as a functional system, yet these expenditures do not create any added value for the mission of healthcare. The necessity to ensure universal coverage, especially in the developing countries, goes along with the imperative to go tight on healthcare expenses. Improving efficiency seems to be the core challenge for healthcare systems all over the world (WHO 2010). In any given country, one question returns recurrently: "how much will be enough, next year, to make that whole health business work properly?" Paraphrasing Paul Krugman's well-known metaphor about trade, if a politician in the United States declared that he or she is able to supply hospital healthcare at half the current cost, with quality held constant, to their fellow citizens, they would immediately be elected president. The moment that the fellow citizens discovered that the scheme stipulates sending American patients to Paraguayan hospitals, the person in question would be immediately subject to impeachment and possibly to

criminal prosecution. The money spent on healthcare is among the most significant categories of public expenditure, and thereby among the most important factors of public debt accumulation.

Over the last two decades, most countries in the world significantly increased their healthcare expenses per capita. In the same period, the average life expectancy of the global population had grown just by 3%, from 66 to 68 years. The financial input seems to be disproportionally high in comparison to the human output, so to say. In most countries, the growth of healthcare expenditures has been absorbed principally by the public pooled funds, frequently at the expense of the private sector (WHO 2011). For example, in Australia, 22.25 billion of Australian dollars (PPP) was injected in the healthcare system over eight years, in addition to the previously spent 58.5 billion per year, with the life expectancy having grown by just 2.5%, from 80 to 82 years. Out of these 22 billion, 13.7 billion was absorbed by the public healthcare system and 8.5 billion was spent on the growth of the private healthcare market.

The line of research represented by the World Health Organization focuses mostly on ensuring universal coverage in healthcare, which is closely connected with the modalities of financing. The private, out-of-pocket system of payments for healthcare services (OOP) makes up almost 50% of the global financing of healthcare systems and is visibly inversely proportional to a given country's level of income. In high–income countries, the share of OOP in the total health expenditure (THE) is barely above 36%, reaching about 70% in upper middle-income countries and exceeding 85% in lower-income ones (Falkingham 2004; Dummer, Cook 2007; Durairaj et al. 2010a). The efficiency of healthcare financing considerably depends on the efficiency of the actual supply of healthcare services. No system of financing is efficient as such. An important issue here is the link between money and infrastructure. Significant path dependence can be noticed: new directions of financing can hardly create new infrastructure, but the existing infrastructure tends to attract financing (Durairaj et al. 2010b). It has been proven possible to build highly efficient, demand-based healthcare systems, for example in Chile. In order to be effective, however, such systems require well-developed information systems (Missoni, Solimano 2010). There is a significant substitution in households" budgets all over the world between the consumption of privately paid healthcare and other goods (Kabawata et al. 2002; Saksena et al. 2010). It seems that private health insurance, in comparison to simple out-of-pocket direct payments for healthcare,

improves the overall availability of healthcare (ibidem). Pooled funds play a significant role in financing healthcare systems. From the political point of view, social acceptance of redistribution in financing healthcare is an important factor of success in creating and maintaining pooled funds. There is a body of evidence which suggests that the social acceptance in question is, firstly, highly country-specific, even at the same level of income per capita and, secondly, that the most widely accepted pattern of pooling is the coverage of approximately half of the total healthcare expenses through various means of financial solidarity (James, Savedoff 2010). There is a sharp difference between potential and effective demand for healthcare. The latter depends on a given population's willingness to actually use healthcare services, which, in turn, seems to be proportional to the broadly defined social status, education included (Gakidou et al. 2010; Xu et al. 2010a). There is a body of research which aims to define the optimal level and institutional mix of healthcare expenses. Some findings suggest that a mix of 5–6% of the GDP spent on healthcare by the government, combined with out-of-pocket payments making up about 15–20% of the total health expenditure, guarantee a high efficiency and sustainability of the healthcare system. The same research indicates that only high and upper-middle income countries are able to work out an institutional mix of healthcare expenditures close to that ideal. The same countries display a clear tendency of healthcare expenditures to grow faster than the GDP, a pattern not to be encountered in low-income countries. Moreover, private out-of-pocket healthcare expenses grow faster that the public ones, and the former are elastic to the latter, in proportion above 1.00, without an obvious elasticity in the opposite direction (Musgrove et al. 2002; Xu et al. 2010b). Healthcare infrastructure is mostly urban and healthcare services are mostly urban amenities. The development of health infrastructure is strongly linked to the overall urban development (Gakidou et al. 2010; Xu et al. 2010a; Kabawata et al. 2002; Saksena et al. 2010; Missoni, Solimano 2010). With healthcare being financed from many sources, an important feature of the system is optimal, mutual complementarity of individual sources (modalities) of financing, i.e. they should have as separate domains of application as possible, without overlapping (Le Gargasson, Salome 2010). The efficiency of healthcare spending is highly idiosyncratic between countries. There are many cases of national healthcare systems which, with relatively meagre financial means, achieve much better results, whilst, at the same time, many high-income countries use their

healthcare financing in clearly inefficient ways (Häkkinen, Joumard 2007; Stenberg et al. 2010).

There seems to be a curvilinear correlation between healthcare spending per capita and life expectancy. That correlation translates into a remarkably high elasticity of life expectancy to healthcare expenditure per capita in countries with low healthcare spending, and a quickly declining elasticity as expenditures per capita get higher. Countries which produce a remarkably higher health output for the money spent are not distinctive by their efficiency in healthcare but rather by the universal coverage and accessibility of their healthcare systems (Evans et al. 2001; Chisholm, Evans 2010).

The trend of change in healthcare systems, observable in the world during the past decade, in connection with the line of research that dominates the WHO discourse, invites the following question: to what extent is the long-term development of national healthcare systems and the associated financial changes predictable? Are there any established patterns of change? This general question covers both marginal efficiency and systemic idiosyncrasy. Firstly, the WHO research focusing mostly on cross-sectional comparison begs for a more dynamic study, in the sense of links between the marginal changes. In other words, given the current, cross-sectional image of various healthcare systems in the world, what are the factors that determine the optimal use of each additional million of dollars fuelling the healthcare funds? Secondly, to what extent are national healthcare systems really idiosyncratic? The WHO discourse suggests that the degree of idiosyncrasy is very high, and that any transposition of healthcare institutions from one country to another is most uncertain as for the outcomes obtained. These two issues refer to two streams of institutional economics. Firstly, as contracts are an important aspect of healthcare systems, the issue of transaction costs, put in a broader context of the new institutionalism, is an important theoretical asset. Secondly, as far as institutional idiosyncrasy is concerned, the reference to the old institutional school seems quite obvious. It assumes that the system of financing healthcare is composed of imperfect contracts. As these contracts are drawn up and implemented, the opportunistic behaviour of social agents, combined with a noticeable specificity of assets and bounded rationality, produces substantial costs of managing the whole system, according to Williamson's theory (Williamson 1975, 1985, 1991). Opportunistic behaviour seems, by far, to be most important and the most scalable factor of transaction costs in national healthcare

systems. Corruption and nepotism connected with public procurement in healthcare can serve as a good illustration to that. In moving from the new institutional, theoretical context to the old institutionalism, the most important issue to consider seems to be the institutional stability of national healthcare systems. The old institutionalism points out that institutional systems form gradually, with the voting of legal rules being just the first step in the process in which economic agents gradually develop typical patterns of behaviour, and these patterns shape, in turn, the legal rules (see for example: Hodgson 2000, 2006; Searle 1995 2005; Joas 1996; Twomey 1998; Kilpinen 2000). It is both an empirical observation and a theoretical development of the old institutionalism that countries with relatively inefficient institutions cannot simply switch to more efficient ones, the process of such change being progressive and imperfectly efficient in itself (Aoki 2007). Similarly, in the line of the old institutionalism, it should be kept in mind that institution forming takes place in polycentric social systems, with the degree of decentralization being a very important factor of efficiency (see for example: Ostrom 2010; Agraval, Gibson 2001; Schlager, Ostrom 1992).

Any given national healthcare system displays a specific quality of healthcare that can be estimated as the average life expectancy at birth and as the average healthcare expenditure per one year of life expectancy. The quality of healthcare obtained with one unit of healthcare financing differs from country to country. For a given population of patients, there is a given set of theoretically available healthcare goods (drugs included) defined on the grounds of the currently best and internationally recognized medical practice. Each healthcare good provides specific utility, which is assessed, among others, on the grounds of possible complementarity and substitution with other healthcare goods. For example, physiotherapy may be, to some extent, the substitute of surgery, each of them being complementary to a subset of drugs. The assumption of objective needs is very important in defining the demand for healthcare as such demand is not grounded in what patients want, but in what they need, in line with the best current medical practice. Of course, it does not exclude the existence of all kinds of medical "whims" such as unnecessary plastic surgeries or weight loss clinics. These kinds of medical (or rather vaguely medical) services are not part of the healthcare system according to the present model and are not included in the definition of demand for healthcare goods. Demand for healthcare is a kind of a technological frontier for any given national healthcare system, i.e. the most advanced

basket of healthcare goods possible. The individual quality of healthcare depends on the actual accessibility of state-of-the-art healthcare goods to a given patient. Accessibility, in turn, is equivalent to the probability that a given patient receives exactly what they need in terms of healthcare goods. There is usually a social status threshold below which a given patient does not have access to healthcare goods. The individual quality of healthcare may be improved e.g. through compensating relatively high prices of certain healthcare goods with more affordable prices of other healthcare goods. At the collective level, the overall quality of healthcare in a given country depends on the distribution of social status across the population. The relative performance of the given national healthcare system partly depends on exogenous factors such as expected quantities and expected prices of healthcare goods as well as on the social structure in place. They form a context in which a given level of healthcare expenditures ensures a certain accessibility of healthcare. As a rule, national healthcare systems are imperfectly efficient in translating healthcare expenditures into life expectancy. Life expectancy at birth mostly depends – in addition to the obvious genetic and environmental factors – on prenatal medical assistance and on the supply of paediatric healthcare goods: vaccinations, current medical assistance, etc. The actual utility of these healthcare goods substantially depends on their universal accessibility. For example, vaccinations are efficient when applied to the vast majority of the population; vaccinating just the wealthiest 20% is pointless as regards life expectancy.

The greater the magnitude of change in healthcare expenditure and the greater the corresponding structural shift in the financing, the greater the transaction costs of change and, therefore, the lower the carryover from healthcare expenditures to the quality of care actually provided. On the other hand, quick and profound institutional changes seem to be much more efficient than incremental ones. The former generate efficiency gains, while the latter seem to generate mostly costs. Most institutional reforms in the healthcare sector, proclaimed by many countries, tend to be superficial, without any real outcomes in terms of efficiency. Moreover, the expected value of public procurement for healthcare goods provides incentives to invest more in infrastructure, which eventually generates further increases in public procurement, healthcare quality being still of secondary importance in the whole process. Some clearly separate cases emerge; they are small economies, displaying real, deep institutional changes, combining decentralization with a profound

review of contractual patterns. There, structural shifts in healthcare financing really seem to work. Unfortunately, such highly efficient patterns of institutional change in national healthcare systems are essentially not sustainable, as they are grounded in processes clearly limited in time.

A significant shift of healthcare expenses towards public, pooled funds seems to be counterproductive: they bring more in terms of wages for the healthcare personnel than in terms of patients" life expectancy. Moreover, most of the so-called "reforms" reported by the WHO in many countries are not real reforms; they consist in an otherwise logical accumulation of capital around the existing healthcare infrastructure.

Constitutional states are essentially territorial communities. Both words, namely "territorial" and "communities", are important. Constitutional states are communities specifically linked to territories. When the link between the population and its territory becomes blurred (when populations move a lot faster than they used to), the very foundations of constitutional states start to shake. Such a statement might seem unnecessarily pompous, but when we think about the rise and fall of all great empires in the history of mankind, one common denominator emerges: migrations. China, Rome, the Inca Empire, Egypt, Persia, colonial empires of the Spanish and the British crowns – all those political structures which formed on the grounds of various kinds of migration and fell apart when the migratory movement stopped or was reverted.

In 2016, when the present book was written, migration was happening so fast that by the end of the year (October 2016) the Department of Economic and Social Affairs of the United Nations had not managed to issue a full and definitive *International Migration Report* for 2015. At the moment of writing this book, only a working report entitled *Highlights* (United Nations 2016) was issued. Those highlights, although brief, are quite informative. In 2015, the number of international migrants (according to the UN classification, slightly different from the one used in the previously cited World Bank data) reached 244 million, 41% more than in 2000. Europe and Asia host almost two thirds of all international migrants, respectively 76 million and 75 million, with North America being the third largest temporary home (54 million). As we pass from continents to individual countries, the United States of America is the champion of that forced hospitality (47 million international migrants). Germany and the Russian Federation follow closely. Yes – the United States and the Russian Federation. Are they not the same actors who are

currently moving the international fixture around? Yes, indeed, they are, and it can be plausibly claimed that they are doing so because migratory processes have stirred some fundamental social forces. Of course, at this point, any reader can protest that talking about "social forces" is a kind of metaphysics. Still, this is an old intuition, present in the philosophy of Newton, Leibnitz or Descartes. If something moves and has some mass, then movement combined with mass creates force. Force moves other things, etc. When people move, that movement is accompanied by substantial mass, indeed. This is a force, and it changes things around.

In 1970, Spencer H. McCallum published a short book entitled *The Art of Community* (McCallum 1970). Supposed to be a cornerstone in the libertarian ideology, that book generally discussed the importance of real property (i.e. land and buildings) in the development of societies. Right at the beginning of the book, McCallum asked a provocative question: is a hotel a community? He came to the conclusion that a hotel has, indeed, all the properties of a community. Using contracts, we can organize any community, as a matter of fact. Yet, only some territorial communities have become states. What is the special link between capitalistic contracts and political power? This is very much the subject of the present book. In the foreword to *The Art of Community*, F.A. Harper wrote: *Most of us see major changes in society only after they have come to pass. We experience the change but without conceiving of it in advance, and so we do little or nothing to help forward it*. How true...

Demographic growth means more people living in a given territory. Social relations become increasingly complex, therefore rules are required and so is their enforcement. When demographic growth is coupled with significant migration, delimitation of the territory and its protection become more and more imperative. This is probably why constitutional states progressively emerged in the times of rapid demographic growth. Constitutional states are particularly functional when it comes to controlling a territory as well as creating and enforcing a legal system.

Demographic slowdown, as a general phenomenon, means that for any given business in any given place affected by such slowdown, the final market of consumer goods grows at a slower and less attractive pace than before. According to the old Smithsonian principle, the size of businesses is determined by the size of the market. During demographic slowdown, businesses find themselves in a dilemma. On the one hand, they can reduce their individual rate of growth (e.g. their accumulation of capital) in accordance with a slower growth of the market. On the other hand,

they can expand, through trade, the geographical scope of the market they actually reach. When, in that limited market, people start to move faster, we have a limited market with an increased need for adaptation. **The international political landscape is changing, probably strongly pushed by the long disinherited cousin of economics- demographics. The change is taking place at the level of business as new trade agreements are being negotiated and signed. There is something going on at the intersection of capitalism and political power.**

There are categorical opponents to the constitutional states as such, and they vigorously deny the possibility of successful reforms in the constitutional state. New forms of economic governance have emerged during the last decade, to mention initiatives such as Seasteading, Start Up Cities, the Venus Project or the movement of collaborative commons. The Start Up Cities Institute is another private venture centred on the concept of innovative urban solutions. The overall idea of the project is to apply the general paradigm of the startup business to create new cities or radically change the existing ones. According to Zachary Caseres, the president of Start Up Cities, *the concept* [...] *involves a new, experimental economic model for making towns and cities entrepreneurial endeavors in themselves. This model makes tenants and local officials shareholders in the profits of their neighborhoods, the same way members of startup teams take shares of equity instead of high salaries as they come on board* [http://smashd.co/startup-cities (accessed: 20.12.2016)]. One of the flagship ventures of the Start Up Cities Institute is Sandy Springs, a town located in Georgia, US It was incorporated as a startup in 2005 and, nine years after its creation, had 90 thousand inhabitants, had 20% systematically invested into public infrastructure and had a net financial reserve of USD 35 million (i.e. instead of public debt, the local government had a net claim on the rest of the world) (see: Porter 2014). Friedman and Taylor (2012), whilst advocating for the Seasteading Project, argued that the constitutional state that we presently have is inherently impervious to any deep reform of its institutions. Their reasoning refers to Joseph Heller's *Catch-22*: no system can generate the rules that would radically change its rules. Institutions can engender only such new institutions that are based on the old institutions. Truly deep institutional changes can emerge only when non-institutional, exogenous factors change. Technological development can enable the existence of completely new types of communities – permanent and autonomous – and this is the only way to devise new types of social governance. The central thought followed

by Friedman and Taylor is well known in the world political activism and economics: governments should compete against each other for citizens, and such competition can force them to improve. The original claim of Friedman and Taylor is that rules and institutions should be treated as technologies and be subject to innovation exactly as technologies are. Technological innovation is based on experimenting, dramatically absent in public governance. If we want to maximize the pace of innovation, switching from one technology to another should be as easy and cheap as possible, and entering the market for commercialising a given technology should give rise to relatively low costs of entry. Thus, facilitating institutional development should be correlated with creating optimal conditions for experimenting with new institutions and for implementing them at the lowest possible cost. As competitive markets are reputed for driving down costs efficiently, competition between governments is crucial for minimizing the costs of institutional innovation.

The Venus Project is another private venture, created and developed around its charismatic leader, Jacques Fresco, a French architect. Advocates of the Venus Project claim that humanity can face most of its existing problems simply by a better coordination of the use of resources (see for example: Fresco 2007). The Venus Project seems to be linked to the old, initial concept of general economic equilibrium seen as perfect coordination of the social system according to the 19th century vision by Leon Walras. The Venus Project aims, above all, to create a completely new paradigm of environmentally and socially responsible governance based on a nearly perfect coordination of the use of natural resources. From the technical point of view, the project promotes the creation of new cities, among them some floating ones located in the open sea. Unlike projects like Seasteading or Start Up Cities, the Venus Project seems attached to collaborative forms of governance rather than to corporate ones.

All the three initiatives are punctual in the sense that so far they have been strongly localized experiments, frequently still in the embryonic phase. Yet, they all share common traits. Firstly, they are focused on the city as the basic unit of public governance. Thus, they do not propose solutions for governing whole constitutional states and frequently, as the theoreticians of the Seasteading Project do, they consider the constitutional state as an obsolete structure, burdened with inherent flaws. Still, some general patterns are spreading globally. The growing popularity of collaborative structures in high-tech industries is a good example.

Those collaborative structures that Jeremy Rifkin (Rifkin 2014) called the "collaborative commons" are relatively open communities of inventors who support themselves mutually within the community and share freely their inventions. From the legal point of view, collaborative commons establish as little property rights as possible. Among others, they systematically avoid patenting and other forms of legal protection regarding intellectual property. Technologically, they depart from the traditional industrial model of the factory, i.e. one big centre of production that supplies a vast market, being replaced by small, local communities focused on developing technologies to sustain their own, local existence. The Linux system in the software industry is one of the best-known examples of collaborative commons. Another is the social movement of engineers specialized in 3D printing; they actively accumulate and freely share 3D-printable designs that allow local production of goods. The advocates of collaborative commons claim that the constitutional state was created and exists mostly in order to protect and enforce the extensive system of property rights.

A little speculation is due at this point. What if those relatively novel initiatives, more or less localized, were just the tail side of the coin whose head side can be summarized as the globally observable movement of capital away from strong executives in the government and towards more dispersed structures of political power? What if there is some common denominator between the economic success of Chinese federalism, the more localized success of the flexible legislative in New Zealand and the emergence of initiatives like Seasteading, collaborative commons or Start-Up Cities? That common denominator could be a radical rethinking of the division of powers in political structures and an abandonment of the division into the legislative and the executive. It is useful to notice that there is at least one common point between Chinese federalism and the Seasteading project: fewer middlemen (e.g. ministers) between the job to be done and the people who determine how it should be done. In other words, less ministering and more passing directly from decision to action. Maybe we should reduce the executive in order to save the constitutional state? Some clichés suggest such a vision:"the legislative, without the executive, cannot have anything done" is probably the most important. Yet, experience denies it. Governments need capital in order to have anything done, and capital is running away from strong executives towards flexible legislatives. Strong executives tend to repel their basic resource. "All those local things like Seasteading or collaborative commons

are small things, and they would not work on the scale of whole countries" is another cliché. Still, the executive branch in the government spontaneously forms small units, responsible for carrying out the actual job to be done. All the hierarchy of ministries or departments in the executive branch is there just to supervise those small units, and said supervision tends to reduce the efficiency of the whole structure.

We can have efficient constitutional states with much less power in the executive and a much more flexible legislative. A legislative body thinking in terms of sequences to perform, without the constraints of budgetary unity, could devise and implement new policies (i.e. adapt quickly to the changing environment) in a cycle of two to three months. With the executive branch to carry out those policies and the principle of budgetary unity, the two branches taken together tend to change their policies in a cycle of at least two to three years: it is twelve times longer! We live on an overcrowded planet, which will become even more overcrowded. Flexibility and capacity to experiment with public policies seems to be among the prime virtues that should be expected of modern democracies.

Chapter 2

The fiscal function of constitutional states

In this chapter, the general theoretical path outlined previously is developed as an argumentation around two hypotheses: a) **fiscal policy can be viewed as a collective technology of channelling capital across the social system, and b) there is a significant relationship between the structural characteristics of the political system in place and the way this system manages capital balances.**

Political power rests on a temporary balance between the legitimation granted to governments and the capacity of those governments to appropriate capital. Appropriation is to be understood in a broad, business-like approach: having capital means controlling it or, in a more legal language, to be in possession of capital. Possession is just loosely linked to the ownership of capital goods, is based on various specific legal entitlements and provides more economic power that property rights as such. The example of an investment fund, entrusted with the savings of individual households, is useful to clarify the issue. From the strictly legal point of view, any participant in the investment fund remains the owner of the capital entrusted with the fund, i.e. they can withdraw their participation, move it to another fund, etc. All that the managers of the fund are legally entitled to is temporary possession of the entrusted capital, and all their rights regarding that capital are derived from the original property rights of the small savers. Yet, as we move from the legal status of those social agents towards their economic situation, the landscape transforms. A skilled trader in possession of $1 billion for just two weeks can reap a far greater sum in benefits than a household could do with lifetime ownership of $100 thousand.

The capitalistic power of governments lies in their capacity to pool capital balances into larger aggregates, always temporary and generally

based on temporary possession rather than ownership. The acquisition of capital balances into the activity of the body politic is classically divided in two types of policies: monetary and fiscal. This book focuses specifically on the latter. Fiscal policy can be fundamentally explained on the grounds of the so-called "**fiscal equation" or: tax revenues + public borrowing = public expenditures**.

That basic equation can be modified by adding the second component on the right side, namely capital accumulation. Most governments, whatever their current fiscal flows, hold some capital goods other than the financial means necessary to finance current expenses. The right side of the equation represents the numerical outcome of the structure at work. The structure in question is made of four types of public entities, namely: budgetary units, public executive agencies, public targeted funds and public-private partnerships. Budgetary units are the building blocks of the administrative structure in the public sector. They are fully financed through the current budget of the government and are fully accountable within one fiscal year. They use capital only for financing current expenditures, and their appropriation of capital is based on the "use it or lose it" rule within the real budgetary cycle. The latter means that the next year's budget is drafted during the second quarter of the preceding fiscal year and voted in the fourth quarter. Hence, the full cycle of capital appropriation in budgetary units is actually two fiscal years rather than one. The institution of consolidation in the current public accounts can create an additional, shorter cycle of capital appropriation in budgetary units. This institution consists in the right, usually conferred to the finance minister or another authority in charge of Treasury matters, to consolidate all the temporarily available financial balances of budgetary units in one account, and to use that account for short-term, financial placements (e.g. overnight deposits).

Public executive agencies follow specific missions ascribed by specific laws distinct from the budget and from the regulations of fiscal governance. These laws form the legal basis of their existence. The mission of executive agencies usually consists in carrying out long-term tasks connected to large non-wage expenditures. The distribution of targeted subsidies, or the maintenance of strategic reserves of food or medicines, are good examples. Public executive agencies have more fiscal autonomy than budgetary units: they receive subsidies from the current budget, but these subsidies usually do not provide the full financial basis for their expenditures. Likewise, those agencies can retain their current

financial surpluses over many fiscal years. In other words, the financial link of the executive agencies with the current fiscal flows is fluid and changes from one budgetary cycle to another. The cycle of capital appropriation in the executive agencies is essentially equal to their actual lifecycle as separate units.

Targeted public funds are separate public entities in charge of managing specific amounts of capital paired with specific public missions to carry out. Just as executive agencies, targeted funds have a separate legal basis of their own. Their specificity consists in quite a strict distinction in their accounts: all the current costs of governance should be covered from the financial rent of the capital managed, and the possible budgetary subsidies should serve only to back up the financial disbursements directly linked to the mission of a given fund. The distinction between executive agencies and targeted funds may be fluid: some agencies are de facto funds, and some funds are actually agencies. The central assumption is that they both appropriate capital quite independently from the current budgetary cycle.

Public-private partnerships are joint ventures through which private agents are commissioned to carry out specific public missions in exchange of subsidies, direct payments or specific rights. One of the most obvious examples are contract-based healthcare systems in which private providers of healthcare services are commissioned to fulfil the constitutional mission of the state to provide for the citizens" health. More subtle schemes are also possible. Private agents may provide, with their own financial means, for the creation of some infrastructure commissioned by the government, and their compensation is the right to use such infrastructure.

The point of all that structural specification is to demonstrate that the broad category of fiscal flows that we like to call "public expenditures" (mostly for the sake of convenience) is actually a financial compound. It covers both the expenditures strictly spoken (i.e. current payments for goods and services) and capital outlays that accrue to many different pockets of capital appropriated by public agents in many different ways. Capital accruals have different cycles, ranging from the ultra-short (days or weeks) cycle of consolidated accounting in budgetary units, passing through the mid-range cycle of appropriation in executive agencies and public-private partnerships, up to the frequently manydecade-long cycles of capital appropriation in targeted public funds. Each of those pockets of capital makes a unit of economic power in the hands

of some public agents. Each accrual to or from such a capital pocket means a shift up or down in the actual economic power of those agents. The total stream of financial inflows to public treasury, through current revenues and current borrowing, is congruent with the sum of the public expenditures and capital accruals in the public sector. The cash-based model of budgeting allows public agents to keep some bills unpaid until the creditors become impatient in legal terms, thus to create an illusion of good fiscal performance and to pump up gross public indebtedness. Similarly, that system allows for leaving some tax claims without actual enforcement, thus creating a discreetly governed system of unofficial tax crediting for the chosen ones. The cash-based system is the very foundation of all the small, semi-hidden pockets of capital present in the public sector.

Thus, it can be argued that the total stream of financial inflows to public treasury, through current revenues and current borrowing, is congruent with the sum of the strictly spoken public expenditures and capital accruals in the public sector. Each such accrual corresponds to a pocket of political power in the structure of government.

Thus, public agents can purposefully retain liquid assets. The magnitude and liquidity of such retention is somehow correlated to the political system in place. National idiosyncrasies with respect to fiscal performance are closely linked to the tendency of the public sector to retain and accumulate liquid financial assets. The accumulation in question depends on the degree to which the legislative organs, through annual budgets, directly supervise the management of liquid financial assets. The more discretion the executive has in the management of those assets, the greater the tendency to accumulate them in the public sector and to demonstrate poor fiscal performance. The main characteristics of the executive freedom and legislative control in this respect are: the inclusion of accruals in liquid assets into the annual budgets voted by the legislative, the discretion of the executive to consolidate liquid assets in the short term, the inclusion of accruals in liquid assets into current budgetary accounting and, finally, the creation and management of executive agencies and targeted funds. The purpose of regulations on public finance is to sanction some strategies of political agents and to deter other strategies with respect to the accumulation of liquid financial assets.

At this point, it is useful to pass from the purely theoretical reflection to more empirically-grounded observation. Three fiscal variables refer directly to the capital held (somehow) by the public sector,

namely: gross public debt, net public debt and the residual difference between the two. When governments borrow, a transfer of capital takes place from the lenders to the government in question. Such a transfer gives rise to claims outstanding until the repayment of debt with interest. The sum total of claims on the public sector, outstanding at a given moment, is the gross public debt. Most governments hold some capital balances in the form of claims on other entities, and some of those claims are deductible from gross public debt. Gross public debt corrected for those deducible claims becomes net public debt. According to the definition provided by the International Monetary Fund in its *World Economic Outlook* database: *Net debt is calculated as gross debt minus financial assets corresponding to debt instruments. These financial assets are: monetary gold and SDRs, currency and deposits, debt securities, loans, insurance, pension and standardized guarantee schemes, and other accounts receivable*.

Thus, there are at least two ways of estimating the financial stance of a government: current fiscal flows according to the basic fiscal equation and something resembling a balance sheet, with gross public debt on the passive side, and financial assets deductible from it on the active side. At any given moment, the capital stance of the public sector has those two dimensions: the effectively absorbed flows of capital lent to the government (gross public debt) and the amount of financial assets of a debt nature. For the sake of convenient presentation that follows, that latter category will be called "**Financial assets of the government**".

Some governments publicly report their net indebtedness together with the gross one. The exceptions are really big economies such as Russia or China, which remain remarkably quiet on their net public debt. This is usually the case when information about those assets (claims) possibly deductible from the gross debt is sensitive, for political or economic reasons. Many experts would like to know the volume of real monetary reserves of the public sector in China, after decades of hugely positive balance on trade. Yet, the information is not disclosed. In the *World Economic Outlook* published by the International Monetary Fund, 77 countries provide official data about the net debt, and thus about the government's financial assets. For the purposes of the present study, the author has compiled the fiscal data of these countries available in the *World Economic Outlook April 2015* database, together with the corresponding information from the Database of Political Institutions published by the World Bank, and with selected variables from Penn Tables 8.1 (Feenstra et. al.

2015)(mostly about the available capital stock). As the DPI in its currently available form goes up to 2012, fiscal data were also truncated at 2012. Table 2 provides the detailed composition of the resulting panel of data comprising a total of 1346 "country-year" observations. The number of observations reported for each country corresponds to the number of years, counted backwards from 2012 and covered by the numerical data. Some countries are an exception to that general rule, with atypical time series (e.g. Syria only up to 2010, or Greece with a fractured time series due to errors in public statistics). This panel of data is further named the "sample of 77 countries".

Table 2. The composition of the "77 countries" database, developed by the author

Country	Number of year – observations	Country	Number of year – observations	Country	Number of year – observations
Algeria	12	Hungary	8	Nigeria	13
Australia	24	Iceland	31	Norway	33
Austria	25	Ireland	33	Pakistan	11
Bahrain	23	Iran	17	Panama	10
Belgium	33	Israel	13	Peru	13
Belize	11	Italy	25	Poland	18
Bolivia	13	Japan	33	Portugal	16
Bosnia and Herzegovina	15	Jordan	25	Qatar	23
Brazil	13	Kazakhstan	11	Saudi Arabia	14
Bulgaria	13	Kenya	15	Solomon Islands	10
Canada	33	Korea	12	South African Republic	13
Cape Verde	11	Latvia	13	Spain	28
Chile	20	Lebanon	13	Swaziland	12
Columbia	14	Lesotho	8	Sweden	20

Table 2. – continued

Country	Number of year – observations	Country	Number of year – observations	Country	Number of year – observations
Denmark	18	Liberia	13	Switzerland	30
Egypt	11	Libya	23	Syria	21
Estonia	17	Lithuania	13	Trinidad and Tobago	13
Ethiopia	21	Malawi	8	Turkey	11
FYR Macedonia	14	Maldives	16	Ukraine	15
Fiji	21	Mali	13	United Arab Emirates	14
Finland	33	Mexico	15	United Kingdom	33
France	30	Morocco	17	United States	12
Germany	22	Namibia	7	Uruguay	10
Ghana	12	Netherlands	18	Yemen	14
Greece	20	New Zealand	28	Zambia	8
Guyana	6	Niger	18		

Source: International Monetary Fund.

2.1. The main fiscal trends observable in the sample of 77 countries

Figures 2–5 show trends in the distributive average of two types of capital ratios. In each country, its gross public debt, net public debt and the government's financial assets are computed as the ratios over, respectively, the GDP of a given country and the capital stock available in the national economy. The values of those ratios are averaged for each consecutive year, and the time series of these averages are possible to trace as trends. As the trends are studied for, respectively, the gross public debt, the net public debt and the government's financial assets, the latter appear as the most stable and predictable over time, whilst the net

public indebtedness is the most prone to quick changes. The average ratio of the government's financial assets to the national stock of fixed, amortizable assets (national capital stock) follows a very steady and gentle yet descending trend. Among the six ratios studied, this seems to be the most structural one in the sample of 77 countries, in the sense that it seems to set the most recurrent and durable pattern. In that selective population of 77 countries, the capitalistic position of states seems to evolve within the framework defined by the proportion between the financial assets held by the government and the fixed capital stock. It is a slowly changing framework against which all the other changes in Figures 2–5 take place. That financial undertow sloped downwards: the 77 governments studied seem to have less and less financial weight in comparison to the stock of fixed assets in their countries. The economic explanation of that phenomenon has to be grounded in one basic assertion: capital usually goes where it finds the best employment for itself. Obviously, its employment in the form of financial assets handled by politicians in the name of their countries is not the best one. As the denominator of the government's financial assets shifts from the available capital stock to the Gross Domestic Product of individual countries, the trend becomes steeper and remains generally descending. Thus, at the beginning of the observation span in 1980, those 77 governments held quite substantial financial assets as compared to the present moment. With time, this item in the global balance sheet of states has deflated like a slightly leaking tire.

As we pass from observing the apparently most stable capital aggregate to the most volatile one, namely to the net public debt, both denominations of that debt (i.e. over GDP and over capital stock) follow some sort of "boxing-the-ceiling" cycle. From 1980 until 1994, the net public debt had abruptly inflated in relation to the current output of national economies and to their capital stock. The temporary ceiling of growth seems to be 22% of the fixed capital stock and 48% of the GDP. Between 1994 and 1999, the average ratio of net indebtedness fell sharply down, to 36.4% of the GDP and 20% of the capital stock. After 1999, the upwards trend prevailed once more and pumped the average net indebtedness of the 77 countries under scrutiny up to 25% of the capital stock and 51% of the GDP (in 2002 – 2003). Another trough followed, hitting the bottom in 2008, with the average net debt equal to 26% of the GDP and 11% of the capital stock, just to initiate another climb since 2009. When the time trend of an aggregate variable behaves in such a jumpy manner, it usually shows that the intensity (i.e. volume per unit of time)

of a process is bouncing against an exogenous barrier. When such bouncing occurs in humans and in whole social structures, it reflects intense experimentation going on. An athlete in search of new records would have such a log of performance, sometimes stunningly good, sometimes much worse. The athlete's nervous system would experiment with new, very demanding physiological patterns and experience temporary limits of his capacity. The same happens to social structures when they struggle to come up with new, viable strategies. The question remains, of course, what such struggling could be about in the case of fiscal financial aggregates. Some answers have already been provided in the earlier parts of the study. Firstly, the global financial economy struggles with a slowdown in the circulation of money. The social structures that we live in have a money-retentive slope and the bouncing curve of the net public debt in the sample of 77 countries could pertain to collective experimentation as to how to give some spin to those ducats. It could be John Maynard Keynes, smiling from beyond the grave and repeating his suggestion that governments should be active intermediaries in the circulation of capital. At this point, it is useful to restate the basic interpretation of public borrowing. Governments borrow capital, and the cumulative sum total of the past borrowing still outstanding (i.e. not paid back yet) is the aggregate gross public debt. Thus, gross public debt present in the balance sheet of a country at a given moment reflects the cumulative effect of the past movements of capital from the private sector all over the world to the public sector of a given country. Some of the capital thus transferred lands in the hands of governments in the form of liquid financial assets deductible from the gross debt or, in other words, in the form of financial claims on the rest of the world, characterized by low risk and high liquidity. If we look at the trend of gross public indebtedness (Fig. 2), it follows a pattern similar to that observable in the net debt, and still the steepness of changes is much gentler. The different phases observable in the net debt are visible, too, but the swing is much slower. Hence, there has been a process of global reallocation of capital by the means of public borrowing, and that process has encountered temporary barriers. From the strictly economic point of view, the main barrier to the allocation of capital is its marginal rate of return, gliding dangerously close to zero. The financial intermediation of states in the global circulation of capital has visibly struggled with the limits in the efficiency of investment. At the same time, governments have retained a steadily shrinking part of capital available as financial assets. All the three trends put together, namely the gross debt, the net

debt and the governments" financial assets, indicate that until the 1970s the Keynesian economic governance, in the fashion of the period following the Second World War, effectively produced governments acting as investment banks, i.e. accumulating and redirecting capital. That process was accompanied by the development of public borrowing as the basic institutional tool for transferring capital. In the 1970s, governments started to depart from the Keynesian course in their policies, their financial assets started to melt, but the mechanism of channelling the movement of capital through public borrowing was in such a swing that it kept working at high speed decades after the Keynesian orientation had faded. Figure 5 shows an interesting tendency in gross public expenditures denominated in the stock of fixed capital (i.e. the ratio of gross public expenditures to the available capital stock), possible to be reconstructed on the grounds of data available in Penn Tables 8.1, in a larger sample (167 countries) and over a longer period (1950–2011) than the author's own analysis. Figure 5 shows two cross-section averages of that ratio: the aggregate and the distributive one. The aggregate average, represented by a continuous line in the diagram, is computed as the total public expenditure recorded across the database in a given year, divided by the total of fixed capital stock recorded for the same year. It follows a gently bell-shaped cycle, with a peak between 1975 and 1985. The distributive average is the temporary average, computed for a given year, of the national ratios of the "public expenditures divided by the capital stock". That distributive average follows a bell-shaped cycle, too, although much more concave than the aggregate one. It shows the predominance of certain policies among countries rather than aggregate tendencies. Clearly, until the 1975–1985 peak, governments had channelled an increasing portion of capital through their public expenditures. That tendency bounced against a barrier which might pertain to the efficiency of investment, although political factors are to be considered, too. Since 1978, the tendency has started to revert, with a growing slope down. Now, the trends yielded by the author's own sample of 77 countries can be superimposed. As the share of public expenditures in the global capital stock started to fall, the share of the governments" financial assets fell, too. Moreover, the global velocity of money began to decline as well. The post-war constitutional state appears as some kind of capitalistic experiment, supposed to create an actively investing economic order along the lines of John Maynard Keynes. Still, the experiment seems to have failed, and the big question is why.

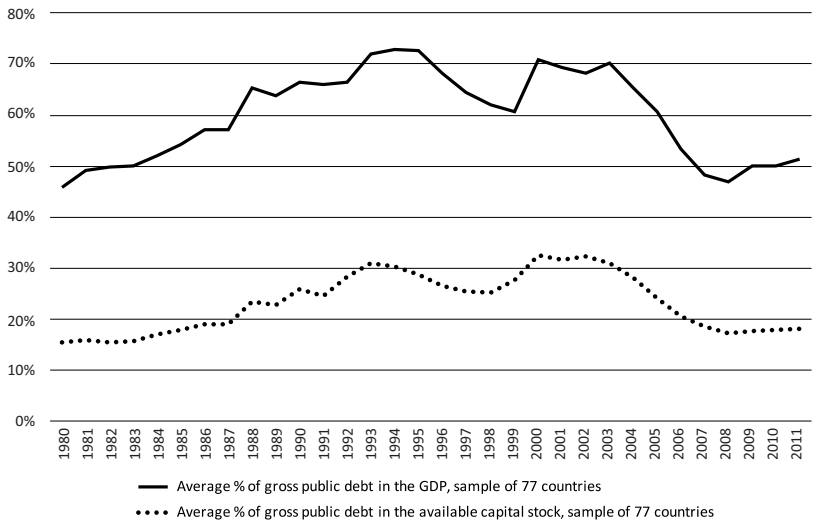

Figure 2. Average gross public indebtedness, sample of 77 countries
Source: International Monetary Fund.

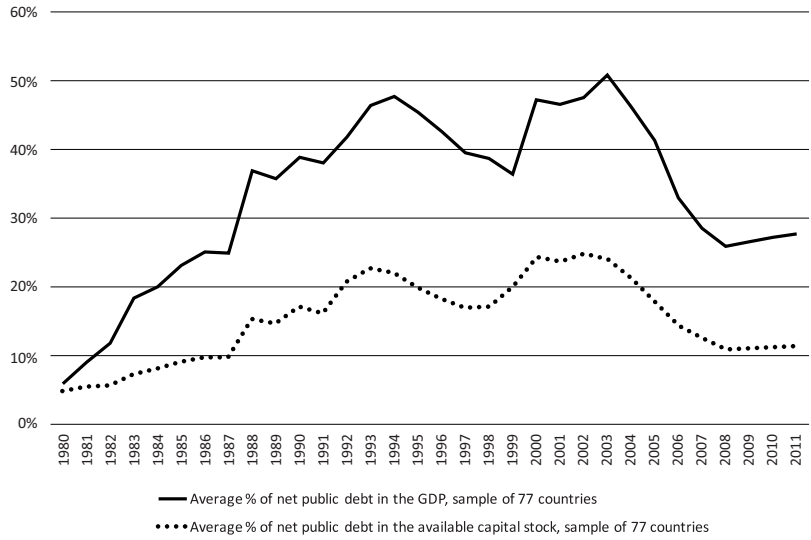

Figure 3. Average net public indebtedness, sample of 77 countries
Source: International Monetary FundSource: Database of Political Institutions, the World Bank.

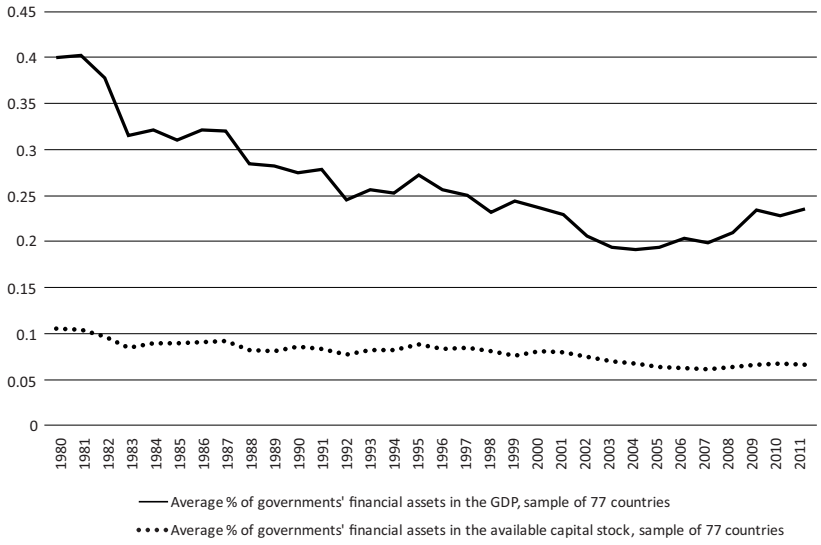

Figure 4. Average stock of liquid financial assets in the public sector, sample of 77 countries
Source: International Monetary Fund.

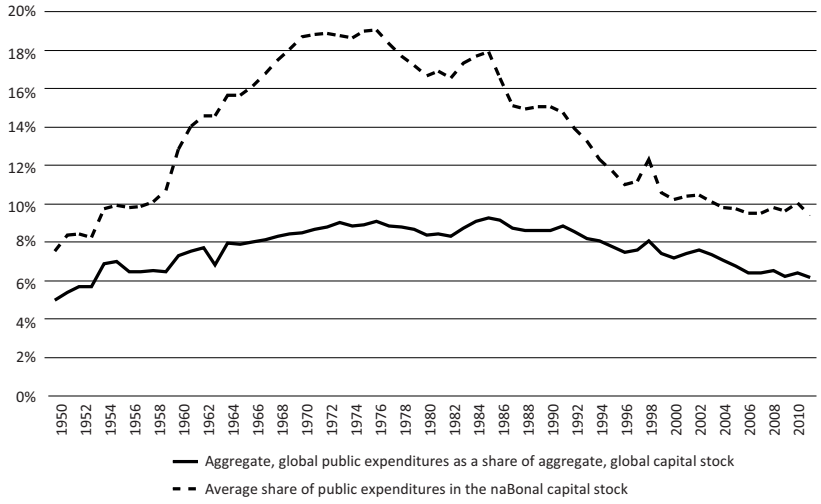

Figure 5. Global average share of government expenditures in the fixed capital stock, Penn Tables
Source: Penn Tables 8.1, Feenstra, Inklaar, Timmer (2015).

2.2. Bank lending, private debt and public debt

The study of data on bank lending available from the World Bank offers interesting insights into the context of the above-presented trends in fiscal aggregates. It is possible to distinguish, in the total category named "credit from domestic banks", the component lent to private borrowers and that granted to the public sector. Of course, as we talk about global economy, the "domestic" adjective is not so important anymore as, on the global scale, all bank lending is "domestic". Figure 6 below presents those two flows of credit as percentages of total bank lending between 1975 and 2011. In the mid-1970s, banks tended to lend much more to the private sector than to governments and still, something was going on in the banking business as those two streams of credit had progressively converged, to meet at equality in 1999–2000. It is interesting to notice that it was the very same moment when the first big trough could be observed in the net public indebtedness of the global public sector. Since then, those two shares have oscillated in close neighbourhood, as if banks and governments were experimenting over the best possible *modus vivendi*. Since credit is the basic financial leverage for private entrepreneurship, governments have basically taken some capital off private business. The short-term trend seems to go exactly that way: Fiscal Monitor October 2016 published by the International Monetary Fund (Fiscal Monitor 2016: 8) shows an intriguing snapshot of the proportions between private and public debt in three developed economies: United States, United Kingdom and the Eurozone since 2004. After 2007, the share of gross public debt in the GDP in all those economies started to grow sharply. The share of private debt to GDP initially followed the ascent (both sectors borrowed heavily), and yet it reverted in 2008–2009; since then, the private sector of the developed economies seems to be deflating its liabilities in a consistent manner.

The issue is to be explored, and the path of exploration is guided by the general question: can the inner mechanics of political systems be the drivers of change in the global allocation of capital between sectors and countries? Of course, some linkages are obvious. The government of the United Kingdom, or that of Germany, has obviously more power to attract capital through borrowing than the governments of Burkina Faso or Nepal.

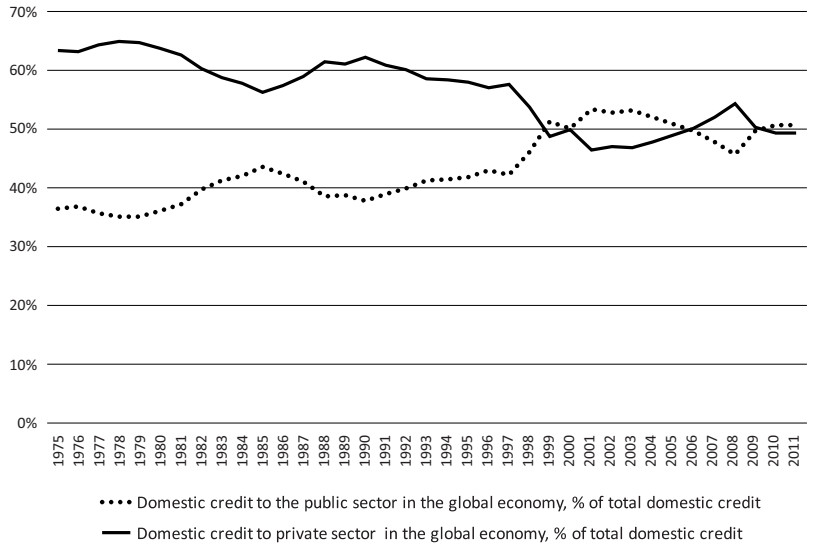

Figure 6. Bank credit to the private and the public sector in the global economy
Source: World Bank.

2.3. The general issue of public debt

Politicians tend to do things that economists qualify as stupid. That is a plain social fact. Saying that a given public policy regarding economic matters is "politically driven" is almost an insult. Yet, treating the political side of public governance as simply "irrational" is irrational in itself. Politics is a set of patterns of behaviour, and such patterns have emerged on the grounds of certain social changes. From the economic point of view, fiscal policy is maybe the most controversial field of public governance.

According to the Fiscal Monitor (2016), reducing public indebtedness is one of the major challenges that the global economy is currently facing. Restrictive fiscal policies leading to that purpose are socially painful, sometimes pro-cyclical and politically risky (if not suicidal). Most of the current research focuses on the short-term, cyclical outcomes of fiscal restrictions. However, another issue is even more important: how durable and sustainable are the fiscal outcomes of these policies? If we succeed in reducing public indebtedness by 5% of GDP today, what is the likelihood of that being a durable gain? Will the public sector stay

mean and lean for decades or will it behave according to a post-diet-yoyo pattern?

The theory of economics, at least the contemporary one, seems to be dominated by the confrontation of two standpoints. On the one hand, there is the economic mainstream based on the assumption that public debt is a burden to the economy (see for example: Meade 1958; Modigliani 1961; Diamond 1965). On the other hand, some *vota separata* to that mainstream opinion have been expressed, e.g. by the early post-Keynesians: Abba Lerner (Lerner 1943) and Alvin H. Hansen (Hansen 1945). Later developments, based on the so-called Ricardian equivalence were brought forth mostly by Robert Barro (Sraffa 1951; Barro 1974, 1979, 1986, 1987, 1989a, 1989b), with a noticeable contribution from James Buchanan (Buchanan 1976).[5]

James Meade, British economist and Nobel Prize winner (Meade 1958), approached the problem of public capitalism from an original point of view on the domestic public debt: what would happen if we removed the domestic public debt from the system. The methodology used by James Meade is of singular interest regarding the topic developed in this book, namely the possible withdrawal of the constitutional state as a whole or some of its components from the social order. The first methodological cornerstone that Meade set is the claim that we cannot really simulate the absence of a common social phenomenon: we can only create artificially a theoretical state of nature without the phenomenon in question and compare it with actual reality. Such comparison can show us the **possible** scope and magnitude of social changes resulting from the removal of a given social constituent, but the exact process of possible changes remains highly uncertain. That opens a larger topic, just hinted by Meade, that the dynamic analysis in social sciences is extremely rare in the literature and really difficult. Most analyses that we tend to see as dynamic are in fact a sequence of stationary states, where we suppose that one stationary state will occur after another. Thus, we assume a dynamic link between stationary states, yet the link itself usually remains metaphysical. Meade simulates a situation where a single, lump capital levy leads to the full repayment of the domestic public debt. Two stationary states are considered: before and after such repayment.

[5] It should be noted that some scholars question the rationale of attributing the concept of "Ricardian equivalence" to David Ricardo's work. See for example: O'Driscoll 1977.

The second methodological pillar used by James Meade is related to the proportions between income from property and income from labour, in the context of unequal incomes in general. Meade rightly assumed that the outstanding public debt, whoever the creditors are, is a capital balance that matters to the economy. Whatever happens to that debt happens to the balance sheet of the social system as a whole. In market economies, capital balances have two functions: they serve to create jobs, sources of income from labour and they bring income from property. The great majority of societies display significant inequalities regarding income and a corresponding disparity in the structure of such income. A general pattern is that the greater the current income a person earns, the greater the share of the capital rent in that income. James Meade's assumption is that *all citizens in any one given income bracket have the same ratio of income from work to income from property*. Domestic public debt is a source of capital revenues for the citizens, but after full redemption that source of revenue disappears.

At this point, James Meade made a relatively blurry assumption that after the full redemption of the domestic public debt each citizen will pay less tax money to the government, and that tax relief will be equal to or greater than the loss of income from government bonds. That assumption deserves a deeper deconstruction as it points at a possible connection between capital held by the government and current taxation. If the relief in taxation is to offset the loss of income from government bonds, the policy of the government should stipulate lowering the tax rate in parallel to or very soon after the repayment of the debt. Thus, the government levies capital from some unspecified sources, repays the whole domestic public debt, stops borrowing and lowers the tax rate. Lower taxes and no new borrowing means lower public expenditures, too. Logically, if the government does not collect more taxes and does not borrow, the only source to finance the redemption of the outstanding debt is the selling of some public assets. Of course, as James Meade emphasized, his assumptions were simplified and served to clear the picture before the theoretical demonstration. Still, the simplification in question shows one important point: if we omit the fact that public debt is a real capital balance with a corresponding balance sheet and start to consider it just as a more or less random total of past deficits, absurdity looms over the horizon. James Meade implicitly assumed that the economy as a whole has some common, unified balance sheet, and that the removal of some capital – the repayment of the domestic public debt – would lead

to rapid development rather than a catastrophe. James Meade did not specify the source from which the money for redeeming the debt should come and where it would go. If the debt in question is domestic, the repayment means a transfer of capital to the citizens. Hence, there is no reason to assume that their property will be decreased.

With all those assumptions in place, James Meade described the society without any domestic public debt (i.e. the society after redemption of the debt) as a system, in which: i) every citizen will own a smaller amount of property, ii) every citizen's gross income will be lower, iii) every citizen's average rate of taxation on income will be lower, but iv) every citizen's net income will be unchanged. In a subsequent development, James Meade claimed that, with a constant net income and diminished property, citizens will have more incentives to save in order to reconstruct their assets. Increased saving would result in reduced consumption (which Meade considered a positive phenomenon, reducing the inflationary pressure), and would create additional incentives for working and doing business. Consequently, the society would rebuild its balance sheet with relatively more private equity in the assets used.

The central thought of James Meade was that the state can be passive or active in the management of capital flows that permeate the economy. He advocated the view that a passive role of the government was definitely a better one as it created more incentives for private initiative.

Against the background of those opposing views on the burden of public debt, a third scholarly stream can be noticed, which points at the mutual relationship between public debt and the distribution of wealth across the private sector. That aspect of the matter was first tackled by Adam Smith himself, who argued that public debt emerges and gains in importance when and only when the private sector accumulates a certain critical amount of capital. Beyond that critical amount, there is more capital that can be used by typical business ventures, and the excess is being lent to the government. Constant interest rate, at low risk, becomes a substantial source of capitalistic revenues. At the same time, the necessity to change the tax policy in order to pay back the public debt creates a spiral-like connection between debt and taxes. Consequently, the whole social structure changes as public debt grows.[6] Interestingly enough, that path of thinking seems to have been largely

[6] That theory is expressed in the third chapter ("On public debts") of the fifth book in his treaty.

neglected by economic sciences, with the "burden or no burden" dilemma taking the lead. It is to be noted that Franco Modigliani, cited above, with his very original approach, seems to have returned to the intuition of a correlation between public debt and private assets. Yet, Gregory Mankiw seems to have really blown the dust off that Smithsonian approach. Starting from earlier research of other scholars (Hall 1978; Shea 1995; Parker 1999; Souleles 1999; Kotlikoff, Summers 1981; Wolff 1998), Mankiw traced a relatively simple model in which he attempted to prove that the accumulation of public debt is closely matched and functionally linked to the accumulation of private property rights in the wealthiest layers of the society (Mankiw 2000).

The main line of confrontation in the economic doctrine as regards public debt is whether it is a burden for the economy or not. At best, in Robert Barro's view, we can assume that debt is economically neutral. Keeping all that in mind, let us have a look at some stylized facts about public debt. At the end of 2011, only 14 countries of the 188 reported did not have any gross public debt, i.e. their public sectors did not have any financial liabilities (World Economic Outlook 2013). The total value of the global gross public debt at the end of 2011 was USD 55 trillion, which corresponded to ca. 79% of the global GDP. Six countries owed over 80% of that total: Japan, United States, Germany, Italy, France and the United Kingdom. The richest borrow the most, so to speak. The question is: what for? Why? Are they all so irresponsible? Another interesting stylized fact comes from the observation of the geography of the net public debt. At the end of the 2011, 89 countries out of the 188 reported by the IMF did not have any explicit net debt. The most interesting are those countries whose governments are indebted in gross terms, yet which have public reserves of financial assets considerably above, or close to, their gross debt: Saudi Arabia, Kazakhstan, Norway, Sweden, Finland, Denmark, Jamaica, Eritrea and Ivory Coast. Those who clearly have plenty of cash borrow even more. Once again, the question returns: what for and why?

As Max Weber wrote (Weber 1947; 1978), a full explanation of social phenomena requires not only drawing a normative model of rational behaviour recommended in a given case, but also explaining the motives that encourage social actors to depart from that model. The theory of politics is traditionally attached to two concepts, both taken from the Weber-Parsons tradition, namely: action and system (in addition to the already cited works of Max Weber, the following seems relevant: Parsons, Shills 1951; Parsons 1949 [1937]). Action is marked by purpose

(or motive, according to Max Weber's strict terms). Actions form a system when we can observe the phenomenon of advanced self-explanation in a set of actions; any action can be explained by its relation to other actions of the set, and there is a clear frontier beyond which we do not need to go for explanation (although, of course, we could). Nicklas Luhmann used the term of "operational closure" to describe that capacity of a system to be self-explanatory (Luhmann 1992). Hence, in order to explain the accumulation of huge public debt in otherwise rich and stable democracies, we need to define a self–explanatory set of actions that can form an operationally closed system. Action and purpose make strategies. This brings us back to the game theory and allows the shift from political sciences to economics. We can assume that there is such an operationally closed system of political strategies, in the sense of Nicklas Luhman's systems theory, which allows the accumulation of public debt as a rational means to accumulate political power. That assumption is confronted with a substantial body of research in political sciences, which proves quite convincingly that some characteristics of the political system are crucial for the accumulation of public debt. The trait that seems particularly important is the relative dispersion of political power, for example among various veto players. The greater that relative dispersion of political powers within the national, political system, the greater the propensity of the government to accumulate public debt (see for example: Tsebelis 2002; Perroti, Kontopoulos 2000; Roubini, Sachs 1989; von Hagen, Harden 1995; Hallerberg, von Hagen 1999).

We face a paradox at the intersection of economics and politics. Having accumulated more public debt than the predecessors did is a typical ground for criticism in politics. It can even become a pretty reliable way to lose political power in the subsequent elections. Why should the politicians in office, in the richest countries of the globe, do something so suicidal? One possible answer is: to promote social outcomes that taxes did not suffice to finance. This is the "distress" logic of public borrowing: governments borrow because they have to, in order to achieve wealth for their citizens. It is not quite clear why any substitution of public capital to private one could not do the job, but let us assume that this is a possible explanation. The second possible answer is: governments borrow because they can, and the richer the society, the more they can borrow, and they make use of this opportunity.

At this point it is worth noticing that the great majority of economic literature devoted to the topic of public debt tacitly assumes that,

in the action of public borrowing, the government is the active part, whilst the capital markets react rather passively. After all, sovereign debt is a low-risk asset... Conversely to the commonly assumed attribution of roles, the present paper returns to the old tenet of Adam Smith, that public debt emerges and accumulates because of the development of capital markets. Adam Smith stated that public borrowing emerged when the private sector had accumulated a surplus of capital, temporarily not used in financing business as such. The owners of that surplus looked for ways to employ those assets in a profitable way, which, in turn, created favourable conditions for governments (monarchs in Adam Smith's times) to become more and more prodigal and borrow more and more from private creditors.

In other words, in the Smithsonian approach we think in terms of a balance sheet and assume that borrowing is always the broke cousin of lending. Does it matter at all? Let us illustrate the problem with the example of consumer loans. If monetary statistics show that households have been borrowing increasingly, the most immediate explanation of any economist is that it is because banks are lending more, thus the supply of money is greater. Further, we could conclude that maybe the interest rates should go up. No serious economist would assume that the dominant cause of the growing borrowing on the part of households is their deteriorating material status. No serious economist would assume that households borrow more because they are in such a financial distress. They borrow more because banks lend them more – that is the canonical (and rational) approach. Yet, in the case of public debt, for some reason, reason does not work anymore. When governments borrow more, we tend to assume that they do so because they have their back against the wall. in fact, there are not many economists claiming that governments borrow more because creditors lend them more and that the capital market is the prime driver of public borrowing.

There is a deeper logic behind that Smithsonian thesis that public borrowing is mostly driven by the supply of capital from the private sector. Instead of seeing the outstanding public debt as the cumulative outcome of more or less random flows of borrowing, we see it as a balance sheet. Public debt has to have a mirroring set of assets financed with that debt. What are these assets? In other words, what durable, capital goods are created on the grounds of public borrowing? Are they property rights? Are they public goods?

All those theoretical questions have practical implications. From the practical point of view, the distinction is between fiscal policies that

effectively work and those that do not. If we assume that the accumulation of public debt is the outcome of financial distress of governments in carrying out their public mission, the logical way of slowing down their run toward the fiscal cliff is to reduce the public mission, in other words to drive the whole society into the conservative paradise. Yet, the obvious drawback of such policies is that, politically, they are seldom enforceable unless the government wants to have a popular upheaval to handle (e.g. the case of Greece or Spain). Besides, social cuts usually bring about the loss of jobs, which deteriorates the tax base and further contributes to the worsening of the fiscal balance.

If, conversely, we assume that public borrowing is mostly driven by the capital market, i.e. by a pressure to transfer capital from one place in that market to another place with the help of specific, low-risk contracts connected to public borrowing, the recipe changes. Find a substitute way of transferring capital with minimum risk, or increase the risk connected to public borrowing, and public borrowing might become useless, or at least much less attractive. If we look again at the old Smithsonian tenet, it can be combined with the previously cited research of Franco Modigliani. Modigliani very convincingly showed that there is a clear, financial transfer from public debt to private wealth. More exactly, it is the transfer from the net public debt to the differential between savings and investment, or S – I. In a broader sense, fiscal decisions influence the allocation of property rights. The reason for referring to property rights is twofold. Firstly, in Franco Modigliani's spirit, it is just as much about balances as about flows. Both savings and investment are flows that alter the balance of assets. Secondly, turning to the Smithsonian approach, we assume that public debt accumulates mostly because private providers of capital want to lend. "Wanting" is imprecise from the point of view of a social scientist. Assessing what people want is essentially psychological in its method, i.e. it is almost impossible to aggregate the "wanting" on the scale of a social system. Social sciences have a set of concepts appropriate for that purpose, namely game theory and its pivotal concept of strategy. Strategies, in turn, are not focused on assets as such, but on the rights to those assets. It is not insignificant whether I rent a house or own it. In both cases, I possess the asset, but only in the latter case I have full benefits offered by such possession. This is the reason for referring to property rights. James Buchanan wrote that *economists should cease proffering policy advice as if they were employed by a benevolent despot and they should look to the structure within which political decisions are made* (Buchanan 1987). Let us follow

this intuition and advance gradually from weak assumptions to stronger ones. We can tentatively assume that the way in which society works may be represented as a social game with imperfect information, in the sense proposed by John Harsanyi (Harsanyi 1953; 1966; 1967; 1968). We can also tentatively assume that strategies played by social actors can be meaningfully characterized by the expected outcomes, the actual outcomes and the modalities of the actual action. We can distinguish three subsets of social actors, namely those striving to acquire private property rights, those aiming to develop political power and those oriented towards creating public goods understood as positive social outcomes, such as reduction of infantile mortality. Note that these subsets do usually overlap (see, for example, the US political system) and they are complex structures themselves. Corporations and financial trusts aim to acquire property rights, and so do their executives as private persons. Likewise, politicians operate within political parties, coalitions, etc., and each of these structures takes steps to develop its political power.

Thus, among all the strategies practised by social actors within a given social system, one can distinguish three subsets: strategies oriented towards the acquisition of property rights, those oriented towards the development of political power and those aiming to create public goods. All are mixed strategies made of pure ones in the sense proposed by John Nash (Nash 1950a; 1950b; 1951; 1953). Pure strategies are defined as pairs made of a particular goal combined with a particular modality of action.

Fiscal decisions, namely taxation, public borrowing and public spending, are pure modalities of action that some social actors, endowed with political power, use to achieve various outcomes. For example, taxation may be used to increase political support, to promote some particular property rights, or create some particular public goods. We also assume that aggregate savings of the society are a quantitative measure of incremental change in the value of the total set of private property rights. Similarly, aggregate investment is a quantitative measure of the way such incremental change of property rights is further allocated between productive assets and non-productive ones. On the other hand, creation of public goods can be viewed as an incremental change in the so-called social indicators used, for example, by the World Bank. There can exist such a set of political strategies where the modalities of action consist in fiscal decisions and which bring significant changes in aggregate saving and aggregate investment, as well as in the creation and distribution of public goods.

Now, let us make stronger assumptions. The capacity to bring significant changes in the set of property rights through fiscal decisions means economic power. Any hierarchical, social structure – states and corporations included – is able to sustain itself over long periods of time if it has both legitimation and economic power. Legitimation is defined qualitatively and quantitatively. On the one hand, it is a set of basic rights and a set of actions to which the government is entitled. On the other hand, the qualitative scope of legitimation can be translated into a quantitative index. Legitimation is grounded both in the past communicative, political action (Habermas 1975, 1979, 1996) and the actual, normative quality of the social order in place (Rawls 1999). Economic power is grounded in the actual control over flows and balances of capital, both financial and physical. Of course, defining political power with reference to economic power is also very much related to the works of Karl Marx.

For any social agent, governments included, legitimacy and economic power can remain in three possible relations to each other. The hypothetical, perfect state of nature is an equilibrium in which economic power is just what the social agent needs to fulfil their legitimate rights and prerogatives and, correspondingly, the actual legitimation is just what is needed in order to exercise the economic power at hand. With a hint of simplification, real political power is to find in that equilibrium zone, or at least in the zone of legitimation and economic power overlapping each other. Legitimation changes slowly, at the pace of legal change, which can take hundreds of years in some cases, decades at best. Conversely, economic power changes quickly, sometimes within weeks. Governments can acquire or lose economic power significantly faster than they can change the scope of their legitimacy, as the former is very much in the swift hands of the executive power, whilst the latter depends mostly on the much steadier actions of the legislative and judiciary branches. If we attempt to see political power in quantitative terms, we can speak of a certain amount of it, possible to achieve through various combinations of legitimation and economic power. Thus, some kind of an indifference curve may be traced, showing various possible structures of a given amount of political power regarding its footing in legitimation and in the control of capital.

The public sector of any given country is an organization or, if we take local governments into account, a semi-hierarchical network of organizations. In that sense, the state is not a monolith but a structured political community. What we can call the behaviour of the state is the outcome of a multitude of individual strategies through which every single subject

belonging to the public sector maximizes their discretionary, political power on the grounds of a given combination of legitimation and economic power. A game-theoretic approach can be used to model the transformation of individual strategies into collective political action. The present paper mostly taps John Harsanyi's theory of games with imperfect information (Harsanyi 1953; 1966; 1967; 1968). The public sector is financed by a flow of capital from the private sector in the form of taxes and public borrowing, and redistributes that flow. Each public agent maximizes the utility derived from the temporary possession of that capital just in the same manner as the agency theory assumes it for the private sector (Berle, Means 1932; Wilson 1968; Berhold 1971; Ross 1973; Jensen, Meckling 1976; Fama, Jensen 1983). At any given moment, there is a stream of public expenses financed by taxes and public debt accumulated at the moment (i.e. the "fresh" public borrowing). The temporary possession of capital absorbed in the form of public debt creates temporary political profits in the public sector, as well as temporary financial profits in the private sector. These current, temporary profits modify the set of property rights which was in place before their emergence. New property rights emerge, and they impact further transfers of capital, i.e. further public borrowing and further taxation.

In that Marxist, social mechanism of capital transfer, the powers of public agents have the social role of quasi-property rights. The constructive possession of capital by public agents relies on the general principle of the sovereignty of the state. It is probably the strongest possible case of constructive possession. Besides the powers expressly written in the law, there is a whole set of discretional powers. The latter emerge whenever the law allows decisional freedom to public agents, either on purpose, or by unwanted collision of legal rules. Those discretional powers are directly proportional to the amount of capital that public agents have possession of within their discretional freedom. Thus, it is to assume that the distribution of discretional public powers across the social system significantly influences the set of property rights.

At any given moment, the current set of property rights is the outcome of a social game, played by k players[7] who participate in public bor-

[7] The concept of player herein is quite broad. For example, a politician may be a minister and a private owner in parallel. As a minister, he takes actions that influence private property rights, and as a private owner, he develops a strategy, too. Besides, players do not have to be individuals; they can be organizations. Hence, there can be players inside players, so to say.

rowing and in its redistribution. Each player plays an individual strategy, defined both by the expected and the actual property rights. Each player formulates expectations as for: a) the future, individual, political and financial profits coming from the expected property rights, b) the acquisition price of future assets, and c) the future, expected transaction costs connected with these assets. Those expectations lead to actions which, in turn, lead to the formation of an actual set of property rights owned by the player, characterized by analogous variables, namely: political profits, financial profits, acquisition price and transaction costs. The relationship of these actual profits and costs to the expected ones defines the coherence of the player's strategy. Players seek coherent strategies, i.e. they maximize coherence in the first place, with the expected gains being of lesser importance. As the next step, players formulate their strategies on the grounds of past coherence. As experience accumulates, each player acquires a modified set of property rights, and again, the strategic coherence is evaluated. This leads to formulating further expectations, etc.

Fiscal policy is grounded in the aggregate coherence of strategies played by all the public agents taken together. The respective coherences of taxation and public borrowing tend to display a significant disparity. The outcome of taxation is highly uncertain. As legal rules of taxation are voted, public agents formulate expectations as to the future tax base and its average rate of taxation. By and large, it comes down to predicting the taxpayers" future economic and legal patterns of behaviour which, in turn, are the outcome of fiscal policy. A vicious circle appears, and the more radical the current changes in tax regulations, the more vicious it becomes. Conversely, public borrowing is a highly predictable set of contracts whose conditions are largely standardized by the practices of the capital market. **As public agents maximize coherence in the first place, their strategies will be naturally oriented towards maximizing public borrowing within the available limits and on considering taxation only as the necessary tool to finance the resulting, residual value of public expenses, impossible to cover with debt**.

Property rights encompass three types of assets: productive (e.g. machinery), real unproductive (e.g. land) and financial (e.g. securities). Since productive assets are highly specific and not really liquid, they display the highest transaction costs. By contrast, the highly liquid and unspecific financial assets generate the lowest transaction costs, real unproductive assets coming in the middle between the two. Individual strategies focused on the acquisition of property rights to productive

assets produce an aggregate outcome measured as aggregate investment. Conversely, individual acquisitions of the real unproductive and financial assets sum up to the aggregate surplus of savings over investment. The strategies of public agents influence the formation of property rights in three ways. As public agents, at the end of the day, are also private ones (all public functionaries are citizens, too), they use the financial profits derived from the redistribution of public funds to acquire property rights. Secondly, the enforcement of discretional powers held by the public agents frequently leads to important investment decisions in the private sector. Public procurement is maybe the best example. Thirdly, public debt consists mostly of securities which are the object of property rights, too. They are financial assets with a low transaction cost, relatively low yield and a very low risk. The more sovereign bonds there are in circulation, the lower the reference level, in individual strategies of property rights, as regards consistency and expected financial profits. A substantial presence of public debt in the capital market tends to bias individual strategies of property rights towards high aversion to risk, high liquidity, low transaction costs and low expected profits. Such strategic preferences mean more money spent on financial assets and on real unproductive ones, at the expense of productive assets. In other words, it means more S – I and less I. At the same time, significant public borrowing gives more discretional power to public agents and increases their appetite for risk, as there is more to gain in terms of such power. Thus, substantial public debt favours relatively conservative strategies on the part of private agents as regards their property rights, and relatively risky strategies on the part of public agents as regards the extension of their discretional power.

The coherence of the public agents" strategies as regards the discretional power grounded in public borrowing modifies the strategies of private agents concerning property rights. Fiscal decisions shape private allocation regarding the type of assets acquired, which, in turn, brings an aggregate result at the level of investment, and **individual strategies of public agents aiming at maximizing discretional power that results from the possession of capital absorbed in the form of public debt, modify the strategies used by private agents regarding the acquisition of property rights**.

The obvious question at this point is about the limits of that pattern of social change. Up to what point may public debt be accumulated? There can be some convergence of interests between the public and the private agents, as everybody gains something through the redistribution

of public debt. Let us study that issue in more detail, with a general focus on possible conflicts of interests. There are two cases when such a conflict is likely to appear: public default in payment and restrictive fiscal policy. Payment default may take several shapes, ranging from the soft rolling-over of the debt (conversion of one set of bonds into another, which ultimately means that the creditor is paid back with bonds, not with money) to the so-called public bankruptcy. Whatever the exact case of default, it adds up to a specific strategy of the indebted government, consisting in discriminating its liabilities into categories regarding their priority of payment. It should be noted that what is commonly referred to as public bankruptcy is a bankruptcy *de jure*, not *de facto* (Eaton, Gersovitz 1981). The government does not lose liquidity; it simply leads the aforementioned discrimination of liabilities to a point at which, in order to keep liquidity in internal redistribution of capital, it suspends completely the payment of other liabilities. Whatever the exact shape of public default, it adds up to a group of private creditors being outnumbered by all the other creditors and stakeholders. Interestingly enough, whilst the soft rolling-over of public debt frequently encounters vigorous opposition of at least some creditors, public bankruptcy usually results in the creation of exceptional financial packages of further loans to the government in default. Most creditors put strategic consistency at the top of their priorities and above all take care not to destabilize the situation.

Regarding restrictive fiscal policy, one assumption is to be made right from the start: they are not initiated because of such moral judgments as: "it is better to be mean than profuse". International political pressure is the key motivating force. That pressure is, in a sense, an anticipated prevention of the possible default, i.e. of discrimination among the liabilities. Some creditors take care not to force the government to reduce the stream of benefits to all the stakeholders more or less equally. Once again, we have one group of creditors that enters into a conflict of interests with all the other stakeholders. Yet, this time, that particular group outnumbers the others.

The type of individual strategies regarding property rights marks the frontier between the conflicted groups of interest. Some private agents prioritize the consistency of investment in sovereign bonds. When they perceive that consistency as threatened by the government's excessive indebtedness, they start preventive action. Should they succeed, restrictive fiscal policy will be implemented. If they fail, public borrowing continues unaltered, with the eventual default in view.

Whilst governments tend to be considered as the most reliable debtors, they also have the strongest position in the possible conflict with their creditors. There is a strong, legal asymmetry based on the principle of *sovereign immunity*. States are sovereign and equal to other states. Ordinary tribunals cannot pronounce any binding verdict relating to the enforcement of claims resulting from public debt. Governments may deliberately limit their sovereignty through contracts, but they cannot be forced to do that (see for example: Brownlie 2003). During the whole of the 19th century and for the best part of the 20th century, the principle of sovereignty was an absolute barrier to the enforcement of any claims connected with public debt. It was not until the 1970s that the law changed, first in the US, then in the United Kingdom and other developed countries, allowing selective waiving of sovereign immunity (Buchheit 1986, 1995). The principle of sovereignty has also its procedural equivalent, known as *the act of state*. The *act of state* principle assumes that the courts of any given country have no jurisdiction over the acts of other countries" governments. As a procedural rule, and differently from sovereign immunity, the *act of state* principle cannot be waived but, at the same time, it does not influence the legal enforceability of claims (Power 1996; Lee 2003; Sturzenegger, Zettelmeyer 2006).

The real influence of the creditors upon the political course of the indebted government, the principle of sovereign immunity being taken into account, determines the limit of public indebtedness. In other words, the accumulation of public debt lasts until a group of creditors that is influential enough forces the government to implement a restrictive fiscal policy. Debt defaults, contrarily to the common opinion, do not necessarily put a brake to indebtedness. In that context, some change seems to emerge but it does not concern sovereign debt as such yet. It is about the investor-state dispute settlement clause included in over 2500 bilateral investment treaties signed by more than 174 countries. That clause, allowing international arbitration in legal disputes between foreign private investors and their host governments, gave rise to a rapidly increasing number of cases and verdicts (for more details, see for example: Franck 2007). Whilst not concerning the issue of sovereign debt directly, those cases seem to be symptomatic of a new pattern of legal approach to sovereign immunity.

Now, we can add even stronger assumptions about the political system. Let us imagine **two alternative political games**. The first alternative is that the aggregate impact of fiscal decisions upon private

property rights is proportional to the political power of the strongest political players. In other words, the more concentrated the political power, the greater the impact of fiscal decisions upon private property rights. This is the world of mighty dictators. The second, alternative game makes the impact of fiscal decisions upon private property rights proportional to the number of political players with any political power, or veto players according to Tsebelis (Tsebelis 2002). This game finds the best description in the French saying "the more of us join in, the more fun we all have".

2.4. Types and clusters of political systems in the sample of 77 countries

The international distribution of political power is pretty straightforward, just as its connection with big capitalism present in the form of multinational corporations. The particular interest of the present investigation is somehow different: it is to explore the way the internal political processes of each individual country possibly affect the appropriation of capital in the public sector. The author's own database of 77 countries offers some interesting insights in that respect. The first interesting observation is the relative clustering of political systems. Both the general Database of Political Institutions and the author's smaller database of 77 countries indicate that national political systems tend to cluster in **three big agglomerates**. **Cluster #1** is made up of plural electoral regimes in presidential systems with no observable polarization in the economic programmes (N = 233 "country-year" observations in the sample of 77 countries); **cluster #2** consists of plural electoral regimes in parliamentary systems, with no observable polarization as well (N = 205), whilst **cluster #3** gathers strongly polarized, parliamentary systems with proportional elections (N = 213). Table 3 shows the detailed composition of "country-year" observations in that agglomeration. For the sake of clarity, the sample of 77 countries is considered here as a panel of data. It means that cluster #1, with 233 "country-year" observations in a total of 1346 "country-year" observations in the database, reflects the probability equal to P = 233/1346 = 17.31% that any country covered by the database between 1980 and 2012 ever becomes a plural electoral regime or a presidential system and no polarization is to observe in the economic programmes of parties present in the national legislative body.

Constitutional orders with assembly-elected presidents are very poorly represented in the sample: 57 observations across both electoral

regimes and all the possible cases of partisan polarization. Hence, this category can be treated as an exception rather that as an important case. Still, an interesting pattern emerges in systems with assembly-elected presidents, namely the absence of moderately polarized partisan structures. This particular class of political systems displays either no polarization at all or a very pronounced one. Thirdly, and this seems the most important for predictive purposes, the analyzed countries tend to stay quite firmly within one pattern of constitutional order over the period of observation, yet they frequently move between various cases of partisan polarization. It confirms one of the theoretical intuitions expressed in the introduction, namely one predicting that the fiscal function of partisan political structures might have a greater practical value that the prediction of outcomes brought about by constitutional changes.

Table 3. The observable clustering of political systems in the "77 countries" database

Electoral regime	Political system		
	Presidential	Assembly--elected president	Parliamentary
Plural elections	**POLARIZ = 0** **N = 233** Bahrain 2003–2012; Bolivia 2006–2012; Chile 2002–2009; Egypt 2006–2011; Ghana 2005–2001; Islamic Republic of Iran 1996–2012; Jordan 1990–2009; Kazakhstan 2009–2007; Kenya 1998–2007; Korea 2005–2012; Lithuania 2000, 2004; Malawi 2005–2012; Maldives 1997–2009; Mali 2000–2002; Mexico 1998–2000; Morocco 1996–2012; Nigeria 2000–2012; Pakistan 2003–2008; Panama 2003–2012; Poland 1998–2007; Swaziland 2007–2012; Syria 1990–2010; United States 2001–2010; Yemen 2000–2012; Zambia 2005–2011	**POLARIZ = 0** **N = 25** Egypt 2004–2005; Greece 1980–1986; Lebanon 2000–2012; Yemen 1999	**POLARIZ = 0** **N = 205** Australia 1989–2010; Belize 2002–2012; Canada 1981–2004, 2012; Ethiopia 1996–2000, 2006–2012; Fiji 2000–2001; France 1983–1986, 2003–2012; Greece 1987–1999; Hungary 2007–2012; Italy 1995–96, 2002–2008; Japan 1981–83, 1987–2012; Lesotho 2000–2002, 2008–2012; New Zealand 1985–1994; Spain 1985–93, 2001–2004, 2012; Trinidad and Tobago 2001–2012; United Kingdom 1980–2010;

Table 3. – continued

Electoral regime	Political system		
	Presidential	Assembly--elected president	Parliamentary
Plural elections	**POLARIZ = 1, N = 35** Bolivia 2003–2005; Brazil 2007–2012; Chile 1993, 2010–2012; Korea 2001–2004; Mexico 2001–2006, 2010–2012; Niger 1995, 1996; Poland 2011–2012; Ukraine 1998–1999, 2000–2002	**POLARIZ = 1 No records**	**POLARIZ = 1, N = 12** Hungary 2005–06; Italy 1994, 1997–2001; Latvia 2007–2010
	POLARIZ = 2, N = 33 Bolivia 2000–2002; Brazil 2000–2006; Chile 1994–2001; Ghana 2001–2004; Maldives 2010–2012; Mexico 2007–2009; Poland 2008–2010; United States 2011, 2012	**POLARIZ = 2 N = 4** Pakistan 2009–2012	**POLARIZ = 2, N = 104** Australia 1999–2012; Canada 1980, 2005–2011; France 1987–2002; Germany 1991–2012; Greece 1993; Italy 2009–2012; Japan 1980, 1984–1986, 1994–1996; New Zealand 1995–2012; 1994–2011; Trinidad and Tobago 2000; United Kingdom 2011–2012
Proportional elections	**POLARIZ = 0, N = 59** Algeria 2003–2007; Cape Verde 2002–2011; Kazakhstan 2008–2012; Liberia 2000–2003; Namibia 2006–2012; Niger 2010–2011; Peru 2000–2012; Poland 1998–2006; Ukraine 2011–2012; Uruguay 2005–2012	**POLARIZ = 0 N = 25** Bulgaria 2000–2001; Estonia 1996–1999; Guyana 2007–2012; South Africa 2000–2012	**POLARIZ = 0, N = 29** Bulgaria 2010–2012; Ireland 1980–1981, 2007; FYR Macedonia 2003–2011; Portugal 2006–2009; Turkey 2003–2012
	POLARIZ = 1, N = 17 Algeria 2001, 2002, 2008–2012; Cape Verde 2012; Israel 2001; Peru 2001–2006; Poland 1996–1997	**POLARIZ = 1 No records**	**POLARIZ = 1, N = 62** Finland 1991–1995, 2003–2011; Iceland 1988–1991, 2000–2007; Ireland 1988–94, 1998–2012; Israel 2002–2003; Italy 1988–1993; Latvia 2000–2006

Table 3. – continued

Electoral regime	Political system		
	Presidential	Assembly--elected president	Parliamentary
Proportional elections	**POLARIZ = 2, N = 7** Colombia 1999–2002; Israel 2000; Uruguay 2003–2004	**POLARIZ = 2 N = 2** Estonia 2000–2001	**POLARIZ = 2, N = 213** Austria 1988–2012; Belgium 1980–2012; Denmark 1995–2012; Finland 1980–90, 1996–2002, 2012; Iceland 1982–1999, 2008–2009; Ireland 1982–1987, 1995–1997; Israel 2004–2012; Netherlands 1995–2012; Norway 1980–2012; Portugal 1997–2012; Sweden 1993–2012; Turkey 2002

Source: Database of Political Institutions.

2.5. Fiscal stances typical for political systems

As pure clustering appears in political systems, the first obvious conclusion is that the political system in place in any given country is not just an idiosyncratic outcome of just as idiosyncratic and quite random a process of local political changes. There is a global pattern in the formation of political structures. The next logical step in the present investigation is to check for an economic pattern associated with the political one. As we start from politics and move towards economics, we can begin with studying the distribution of fiscal aggregates across the three clusters observed. Tables 4 and 5 show an example of what such an insight can look like. Three variables representing fiscal flows have been selected, namely: gross public revenues, gross public expenditures and the structural fiscal balance. Table 4 presents the arithmetical averages of those three fiscal flows as a percentage of the GDP in the sample structured according to the political classification described earlier. Interesting patterns appear. Presidential systems seem to be generally more frugal than parliamentary ones, and systems with plural elections seem to be more frugal than governments appointed as a result of proportional elections (although

the latter pattern is much shadier and less distinct than the former). In presidential systems, the degree of political polarization does not seem to matter, but in parliamentary ones any increase in political polarization seems to inflate the current fiscal flows. Some political systems seem to be more prone than others to appropriate capital for their current fiscal governance. Table 5 shows the averages of capital fiscal aggregates – gross public debt, net public debt and their residual difference interpreted as government's financial assets – in the same category of political systems. The most visible pattern of idiosyncrasy is observable in the latter fiscal aggregate, namely the government's financial assets, and most particularly in the three clusters mentioned before. As disparities in both current fiscal flows and capital fiscal aggregates are summed up, the three clusters appear as truly distinct. Cluster #1 (presidential systems with plural elections, no observable political polarization) yields an average, structural fiscal balance of -2.651% of the GDP, gross public indebtedness of 55.186% of the GDP, while the financial assets held by the public sector

Table 4. Average values of current fiscal aggregates, % of the GDP

Electoral regime	Political system		
	Presidential	Assembly--elected president	Parliamentary
Gross public revenues			
Plural elections	POLARIZ = 0 26.827 POLARIZ =1 26.918 POLARIZ = 2 26.736	POLARIZ = 0 24.471 POLARIZ = 2 13.579	POLARIZ = 0 36.904 POLARIZ =1 41.829 POLARIZ = 2 40.563
Proportional elections	POLARIZ = 0 29.308 POLARIZ =1 31.545 POLARIZ = 2 28.757	POLARIZ = 0 29.818 POLARIZ = 2 35.298	POLARIZ = 0 34.338 POLARIZ =1 42.733 POLARIZ = 2 48.972

Table 4. – continued

Electoral regime	Political system		
	Presidential	Assembly--elected president	Parliamentary
Gross public expenditures			
Plural elections	POLARIZ = 0 29.052 POLARIZ = 1 28.707 POLARIZ = 2 30.884	POLARIZ = 0 34.103 POLARIZ = 2 20.113	POLARIZ = 0 40.072 POLARIZ = 1 46.832 POLARIZ = 2 42.453
Proportional elections	POLARIZ = 0 30.156 POLARIZ = 1 33.067 POLARIZ = 2 32.029	POLARIZ = 0 31.55 POLARIZ = 2 34.134	POLARIZ = 0 37.476 POLARIZ = 1 45.796 POLARIZ = 2 49.926
Structural fiscal balance			
Plural elections	POLARIZ = 0 -2.651 POLARIZ = 1 -2.155 POLARIZ = 2 -4.247	POLARIZ = 0 -16.676 POLARIZ = 2 n.a.	POLARIZ = 0 -3.643 POLARIZ = 1 -4.305 POLARIZ = 2 -1.726
Proportional elections	POLARIZ = 0 -1.913 POLARIZ = 1 -2.676 POLARIZ = 2 -2.036	POLARIZ = 0 -2.607 POLARIZ = 2 n.a.	POLARIZ = 0 -4.108 POLARIZ = 1 -3.159 POLARIZ = 2 -3.089

Source: author's own elaboration.

make up on average 9.151% of those systems" national GDP. In cluster #2 (parliamentary systems with plural elections, no observable political polarization), the average structural balance is -3.643% of the GDP, their gross public indebtedness is 70.739% of the GDP on average, and those governments tend to hold an average stock of financial assets equal to 23.165% of their national GDP. Finally, in cluster #3 (parliamentary systems with proportional elections and high political polarization), the structural fiscal balance converges to an average -3.089% of the GDP; gross public indebtedness amounts to 62.025% of the GDP, and financial assets held by the public sector amount to as much as 46.771% of the GDP.

Clearly, some political systems place much more capital in the hands of political players than others. Both the constitutional and the partisan distinctions seem to matter. A tentative explanation of that phenomenon can be made using the path of research outlined by George Tsebelis and his theory of veto players (Tsebelis 2002). Intuitively, in the presidential system, the power of the political veto is distributed differently than in the parliamentary one. In parliamentary regimes, the power of the veto is vested in the legislative body, and inside the legislative body it essentially follows the distribution of seats. In presidential regimes, the president is a distinct veto player and, according to the current political situation, he can use that veto in different ways. There is a practice, for example, that a political party, overpowered by the legislative vote, persuades the president to veto a given parliamentary act, and rejecting the presidential veto requires (usually) a qualified majority. That qualified majority requires the votes of the overpowered opposition party which can, in such a case, play their political interests against those of the ruling party (or parties). On the other hand, plural electoral regimes favour the concentration of political power in large, most influential parties, whilst proportional systems favour the dispersion of the veto power among smaller parties.

The three political clusters in the sample of 77 countries seem to correspond to different degrees of concentration in the observable veto power at the disposal of political players. We return here to the seminal distinction introduced by Nouriel Roubini and Jeffrey Sachs (Roubini, Sachs 1989), namely that political systems with more a dispersed political power tend to be more lax in fiscal terms that their more concentrated political counterparts. Roubini and Sachs interpreted that functional pattern as the power of governments in collective wage bargaining. A more dispersed political power is supposed to make governments softer in wage bargaining and, more particularly, more profuse in distributing various

Table 5. Average values of capital fiscal aggregates, % of the GDP

Electoral regime	Political system		
	Presidential	Assembly--elected president	Parliamentary
Gross public debt			
Plural elections	POLARIZ = 0 55.186 POLARIZ = 1 48.927 POLARIZ = 2 55.383	POLARIZ = 0 112.071 POLARIZ = 2 60.978	POLARIZ = 0 70.739 POLARIZ = 1 75.684 POLARIZ = 2 53.648
Proportional elections	POLARIZ = 0 90.934 POLARIZ = 1 39.432 POLARIZ = 2 63.105	POLARIZ = 0 40.553 POLARIZ = 2 4.954	POLARIZ = 0 42.491 POLARIZ = 1 53.612 POLARIZ = 2 62.025
Net public debt			
Plural elections	POLARIZ = 0 46.036 POLARIZ = 1 31.829 POLARIZ = 2 41.441	POLARIZ = 0 POLARIZ = 1 POLARIZ = 2	POLARIZ = 0 47.574 POLARIZ = 1 65.77 POLARIZ = 2 35.039
Proportional elections	POLARIZ = 0 70.994 POLARIZ = 1 18.32 POLARIZ = 2 56.36	POLARIZ = 0 POLARIZ = 1 POLARIZ = 2	POLARIZ = 0 34.581 POLARIZ = 1 18.165 POLARIZ = 2 15.254

Table 5. – continued

Electoral regime	Political system		
	Presidential	Assembly--elected president	Parliamentary
Financial assets held by the government (gross debt minus net debt)			
Plural elections	POLARIZ = 0 9.151 POLARIZ = 1 17.098 POLARIZ = 2 13.942	POLARIZ = 0 POLARIZ = 1 POLARIZ = 2	POLARIZ = 0 23.165 POLARIZ = 1 9.915 POLARIZ = 2 18.609
Proportional elections	POLARIZ = 0 19.94 POLARIZ = 1 21.112 POLARIZ = 2 6.745	POLARIZ = 0 POLARIZ = 1 POLARIZ = 2	POLARIZ = 0 7.91 POLARIZ = 1 35.447 POLARIZ = 2 46.771

Source: author's own elaboration.

types of social benefits and subsidies which are supposed to attract voters in the next elections. Yet, the pattern observed in our case is slightly different. The amount of financial assets held by the public sector has no direct impact on the social well-being of citizens. Of course, spillovers are possible (e.g. substantial financial reserves in the government can stabilize the national currency and thus increase the purchasing power experienced by the average voter), but the connection is not really straightforward.

Thus, in the absence of a truly unequivocal connection, we can try a different path of exploration. Instead of implying that political systems display different fiscal stances because of different efficiency, we could assume, for the moment, that such systems have an idiosyncratic capacity to attract capital in general, both to the private and the public sector. Table 6 presents a query into total economic aggregates – the expenditure-side GDP and the available stock of fixed capital – observable in particular political systems. It can be noticed that these aggregates cover all the 1346

"country-year" observations of the database that consists of 77 countries. Hence, the aggregation is presented in the table both in space and in time and reflects the probability that any given US dollar present in the global capital market is invested in a given political system. Countries with plural electoral regimes total eight times more capital and output than those endowed with proportional elections. Parliamentary systems host much more capital and yield more output than presidential ones. Null political polarization attracts the major part of the available capital, although high polarization seems to be more attractive to capitalists than a moderate one. The three political clusters identified earlier seem to be important nodes of capitalistic accumulation, too.

Of course, it can be claimed that what we have here is a strictly economic phenomenon: capital goes where it is used most efficiently. There is a simple way to test such an assertion. As we divide the aggregate output of a given economy by its available capital stock, the resulting ratio "output to capital" (or Q/K) is commonly used as the basic indicator of efficiency in the use of capital. All the political systems fall into the same interval of Q/K, namely between 0.3 and 0.4. Economists would say that their production functions are similar. Similar production functions mean that no political system considered benefits from a definite, economic advantage over the others, at least in classical economic terms. Three basic types of explanations can be considered at this point. Firstly, the reasons for capital coagulating in some political systems rather than in others can be political and not strictly economic. Secondly, it could be a case when institutions matter, i.e. the decisive factor in the observable allocation of capital would be the institutional one. Thirdly, capital could be attracted to territories in the geographical sense of the term rather than towards systemic characteristics of the body politic. The latter could be just a superficial appearance, veiling a compound of demographic, natural and social traits, and all those traits could add up to the Schumpeterian business cycle, with more or less salient opportunities for investing into something new that a lot of people are following. We can continue along that third path and explore the notion of the "emerging markets". The term usually covers countries whose socio-political landscape shows a certain amount of wealth, and institutional maturity, development sufficient not to call them "developing" anymore, but they seem not to present the same profile as the wealthiest economies. Emerging markets tend to attract investors and they do so through a combination of factors rather than by one single characteristic. They just seem to provide a good environment for what many capitalists crave: expansion

Table 6. Gross output and fixed capital stock in particular clusters of political systems, 77 countries database

"system" in the DPI	Electoral regime in the DPI	Political polarization in the DPI	Total observable, expenditure-side real GDP at chained PPPs (in million of 2005US$) (Penn Tables 8_1)	Total observable capital stock at current PPPs (in million of 2005US$) (Penn Tables 8_1)	Cluster
parliamentary	proportional elections	0	9 266 686.488	23 206 609.703	
parliamentary	proportional elections	1	12 564 023.83	41 383 017.447	
parliamentary	proportional elections	2	43 644 975.195	137 049 046.211	Cluster #3
parliamentary	plural elections	0	205 642 064.352	683 773 892.16	Cluster #2
parliamentary	plural elections	1	10 048 112.508	34 721 690.469	
parliamentary	plural elections	2	132 721 810.557	438 491 647.17	
presidential	proportional elections	0	7 326 303.034	21 256 902.661	
presidential	proportional elections	1	1 847 091.211	6 180 750.844	
presidential	proportional elections	2	1 239 883.121	3 523 970.93	
presidential	plural elections	0	166 574 359.262	483 142 002.868	Cluster #1
presidential	plural elections	1	25 522 261.089	77 334 199.488	
presidential	plural elections	2	30 780 858.765	93 262 725.818	

Source: author's sample of 77 countries.

into new, quickly growing markets. The developed, mature economies usually host new, highly innovative technologies and give rise to new markets for those innovations. However, the relative demographic and cultural stability of those countries seems to impose a steady, respectable pace of development on those markets. Developed economies are like a king's court: it is much more about fighting against competitors for something that is already there, than creating something radically new. On the other hand, capitalism has an adventurous, expansive aspect. The biggest capitalistic structures today are organized as corporations. The corporate pattern of doing business was devised in the past in order to dilute risk and accumulate large amounts of capital in order to conquer territories, quite simply. The merchant companies of Great Britain, or the railroad-building corporations in the United States essentially conquered new territories, in the very literal understanding of "conquer" and "territory". Presently, developed economies do not offer much geography to conquer, unless to the truly biggest and meanest players, able to corrupt whole governments. Emerging markets are different. There is a lot of innovation going on there, and it is accompanied by marked demographic growth as well as by that peculiar cultural trait of societies in quest of something new. The author of the present book experienced that strange feeling in the early 1990s, when the formerly communist Poland was turning into a market economy and a democracy. Strange things happen in such places. One day, you walk by a building that you remembered to host a ministry, and suddenly you can see that there is no more ministry on the premises. The building is turning into office space for private tenants. New types of goods just pop up in the market. Distribution networks need some time to catch on the innovation in goods, and from time to time one can see a general store selling cars or a chemist's with half of their commercial space suddenly arranged for selling leather goods. The social environment is just bubbling with new initiatives. While most of them fail during the five years to come, most of a lot is still a lot. Emerging markets offer that peculiar social stir, less violent than a true revolt, but much more dynamic that a stable social order. It is useful to examine the data from Penn Tables 8.1 from that angle, namely the extent to which emerging markets have attracted capital from developed economies. Table 7 presents a snapshot of the shares that selected countries – United States, France, Germany, Japan, China, India, United Kingdom and Brazil – used to hold in the global stock of fixed amortizable assets. There is an observable flow of capital, indeed, from the established economic regimes to the emerging ones. In 1970, the United States held

in total more than 31% of the global capital stock, against a cumulative total of 9% in Japan and China. In 2011, the US share fell to 16.6%, whilst China alone held 18.1%. The United Kingdom went from holding 5.8% of global capital stock in 1970 to 2.6% in 2011. Interesting nuances appear, though, against that general background. Both the ascents and the descents in that global allocation of capital present some idiosyncrasies. The shares of France and Germany fell much less substantially than it was the case in the United States and the United Kingdom. China advanced much more than India or Brazil. Demographics are not necessarily the answer. Between 1995 and 2015, the population of the United Kingdom grew at a pace similar to that of Brazil. The United States presents a much more solid demographic growth than France or Germany. India grows faster in demographic terms than China. What seems to be really characteristic is the flow between stock markets. The flow from the United States and the United Kingdom to China and Japan has been strongly connected with the emergence and development of big and vibrant stock exchanges in the latter two. Brazil had an attempt at creating its own, organized capital market, yet it has remained but an attempt, until now. India, with all its economic momentum, does not offer a place for capital trading comparable to London or New York. Although the booming growth of the stock exchanges in some emerging markets does not seem to have done much to the velocity of money in the global economy, it did move the capital in space.

Capital is concentrated in social structures which combine certain specific institutional and social traits. Demographic dynamics and booming markets of goods can serve, indeed, yet the decisive trait seems to be the formation of some specific institutions. Organized stock markets with good global connections are certainly among them. The development of strong political parties (plural elections) in strong legislative bodies (parliamentary systems), with clearly defined ideological stances concerning economic policy (null political polarization or a marked one) is also an important factor. On the other hand, capitalists seem not to like those institutional environments where political power is either extremely concentrated or distributed in unclear ways. Both paths – strong stock markets and strong political parties in strong legislative bodies – are characterized by a similar streak of bread crumbs, namely a strongly contained and tamed executive power in the political system. Stock markets, as any form of institutionalized market, seem to work the most profitably when the executive branch of the government does

Table 7. Selected national shares in the global stock of fixed amortizable assets (in %)

Country	Share in the global stock of fixed amortizable assets			
	1950	1970	1990	2011
United States	42.3	31.1	22.9	16.6
France	5.5	5.8	4.2	3.5
Germany	7.6	9.9	5.9	4.2
Japan	2.3	6.3	9.1	7.4
China	n.a.	2.7	4.6	18.1
India	5.7	4.2	1.8	4.0
United Kingdom	8.7	5.8	3.0	2.6
Brazil	1.6	1.5	2.3	2.6

Source: Penn Tables 8.1.

not interfere too much in their current transactional business. Markets need regulations (although the biggest players do not like them), but they hate incidental political intrusion. Strong legislative bodies develop when they free the decisional space to develop into, i.e. when the executive is clearly tamed by the constitutional rules. Strong political parties need an environment to grow, and that environment requires a steady, rocking rhythm of legislative elections rather than a quickstep of intra-ministerial appointments. It is worth noting that the amount of financial assets held by the government, as well as the balance between gross and net public debt, previously studied as displaying clear trends in the global economy, are very much attached to the prerogatives of the executive branch in the government. Financial assets held by the government remain under strong discretionary control of either the minister responsible for public finance (e.g. Minister of Finance or State Treasury, depending on the exact constitutional language used), or under that of the central bank, endowed with considerable executive autonomy. As the ratio of the government's financial assets to the GDP or to the national capital stock decreases, the executive has less economic power.

As global flows of capital are considered, another pattern emerges in the sample of 77 countries. Table 8 shows the aggregate net migration

Table 8. Net migration in the sample of 77 countries

Political system	Electoral regime	Degree of political polarization	Net migration in the sample of 77 countries
assembly-elected president	proportional	0	2 275 738
assembly-elected president	proportional	2	0
assembly-elected president	plural	0	976 721
assembly-elected president	plural	2	-1 634 420
parliamentary	proportional	0	449 625
parliamentary	proportional	1	542 670
parliamentary	proportional	2	4 277 336
parliamentary	plural	0	19 022 370
parliamentary	plural	1	137 806
parliamentary	plural	2	16 220 614
presidential	proportional	0	-1 454 155
presidential	proportional	1	-982 897
presidential	proportional	2	-120 000
presidential	plural	0	6 155 706
presidential	plural	1	-5 091 456
presidential	plural	2	2 543 098

Source: author's sample of 77 countries.

recorded in that database by political systems. Parliamentary systems on the one hand, and plural electoral regimes on the other, seem to be a kind of absorptive cores for migrations. The pattern observable in Table 8 is somehow similar, yet not identical to the one showing the accumulation of capital stock in particular political systems (see: Table 6 above). Plural electoral regimes seem to be equally attractive both for people and for capital.

2.6. Conclusion – the institutional foundations of capital appropriation in political systems

Any of the components of the fiscal equation can be governed by the respective decisions of the legislative organs and by those of the executive. Those decisions can be categorized according to two criteria: the type of enactment and the type of procedure. As for the types of enactments, the legislative usually votes over two distinct institutions: annual budgets and permanent legislative authorities, the latter being possibly connected to a more or less formalized creation of fiscal entities. Each of these institutions can be enacted through three different procedures. Firstly, the legislative can vote a bill presented by the executive without amending it, in a yes/no vote. Secondly, the legislative can amend, on its own initiative, the bill presented by the executive and then enact the amended bill. Finally, the legislative can enact its own bill, without any formal initiative coming from the executive organs. The executive can also take autonomous fiscal action within its discretion, without the intervention of the legislative. Thus, each component of the fiscal equation can be enacted according to eight different regulatory patterns combining the two types of institutions, with four possible procedures. Generalizing, any constitutional order of fiscal policy can be represented as a two-dimensional matrix, with one dimension representing the range of possible fiscal institutions and the second one corresponding to the range of possible procedures for bringing those institutions into force. In the constitutional order proper, such a matrix is a bivariate one, i.e. it states whether a given pattern is legally possible or not. Additional, limiting parameters (e.g. the ceiling of the general budgetary reserve remaining at the discretion of the government) can describe the constitutional framework. The actual fiscal policy can be described with a structurally identical matrix filled with different content, i.e. with the actual amounts (absolute or relative to some economic aggregate) levied, borrowed or spent according to each given pattern. The fiscal flexibility of legislative organs, as compared to the discretion of the executive, can be assessed at two levels, namely the constitutional order and the actual fiscal policy. The constitutional order offers possibilities, and the actual policy is informative about the use that political actors make of those possibilities. The relative flexibility of the legislative in fiscal matters seems to be important primarily for the planning horizon of fiscal policy. The basic model in which the legislative accepts or rejects budgetary bills emanating from the executive

covers one fiscal year. Yet, as the legislative becomes more flexible, shorter or longer periods of fiscal planning appear. On the other hand, the rigidity of the legislative in fiscal matters is tantamount to assuming that the executive knows best how much money the public sector needs to run smoothly.

The flexibility of the legislative **allows, de facto, to pursue many policies in parallel, as a sort of experimentation**. The question is how political systems and national economies respond to such experimentation. Experimentation or the tendency to experiment might be an expression of a high fragmentation in the political system. Fiscal flexibility of the legislative might reflect a tendency towards policy change without one clear direction to follow. The fiscal flexibility of the legislative is significant when the legislative actually votes and enacts other policies than those expressed in the bills presented by the executive. In other words, the legislative is really flexible when it can take autonomous legislative initiatives.

The main theoretical basis of the concepts developed here below is the definition of law offered by Herbert Hart, namely that the law is a compound system made of primary rules of conduct selected from among a broader set of rules of behaviour through the application the secondary rules of recognition. Any set of legal rules of conduct can be studied in the context of a broader set of rules of behaviour aiming at the same functional purpose. In other words, legal rules correspond to social strategies as defined in game theory. Legal regulation aims at enforcing some social strategies as valid, against other judged non-valid, and all those strategies must have existed as recurrent patterns of behaviour before the regulation. Thus, any regulation can be studied in the context of strategies alternative to those judged as valid legal rules. Going further along that path, it can be assumed that, functionally, the most important regulations in any domain are those which have the most distinct alternatives in their social context. In other words, the law matters the most in those times and places where the most other strategies are available, and those strategies are clearly distinct in their social outcomes. The number of alternative strategies available is conditioned by the relative value of the desired outcomes: where there is interest, strategies will form. On the other hand, disparity in social outcomes tends to appear in times and at places of high disparity in interests. Where many social agents compete for valuable rewards, many distinct strategies appear. The general question is about the process that leads to the recognition of some social strategies as legal rules, whilst others remain just strategies.

The **institution of budgetary unity**, supposed to put a limit to the autonomy of the executive, actually drives that autonomy. Budgetary unity was probably invented as an institution in the second half of the 19th century, as an advanced tool for transforming the almighty monarchs into the executive organs of the state. The principle of "one budget for one sovereign" helped to control the profusion of the Crowns. With time, however, budgetary unity started to produce quite contrary outcomes. As we can see, the unique budget is principally drafted as a bill by the executive branch that it is supposed to finance. When it comes to parliamentary vote over such a bill, asymmetry of information is clearly to the benefit of the executive. Members of the parliament seldom have the resources needed to claim reliably that a given ministry needs definitely less money than it claims to need. Moreover, the executive branch of the government drafts its budgetary bill during many months; the actual practice is about three to four years in executive planning, as compared with the budgetary act currently in force. By contrast, the legislative body has usually two to four months to discuss and enact the budgetary bill received from the executive. Thus, decomposing the unique budget into smaller pieces and appropriating them separately could be much more functional than budgetary unity. **A strong claim is formulated here: legislative bodies in national governments can take many of the tasks traditionally attached to the executive and carry them out much more directly than they do at present. There are great chances to improve the functionality of national governments with such an approach.** In a broader perspective, it seems that constitutional states need more experimentation with themselves in order to adapt to the changing world. We devise anything new and useful through experimentation. However, whilst we – humans – are quite good at experimenting and innovating with technologies, we tend to be really conservative about social structures. On the one hand, such standardization is a sign of progressive, global convergence towards what we call "democratic standards". Yet, on the other hand, standardization means less experimentation and fewer innovative ideas, whilst governance needs innovation just as machines do (see for example: Oates 1972; Tiebout 1956; Francis & Francis 2011; Janeba, 2006; King 2005). Governments appropriate capital through the institutions of public finance, which find their current expression in fiscal policies. Institutions are based on the rules of conduct which, in turn, are formalized strategies known from the actual experience. The emergence and stabilization of institutions in any field of governance, public finance included,

can be represented as a game with nature, where the probability of devising optimal institutions over *n* steps in the game is proportional to the number of experiments the players can perform in each step. Assuming that optimal institutions are very much an abstract term, we replace the probability of devising optimal institutions with the quality of institutions, measured as the opposite of the distance from the optimal ones. In other words, the more we can experiment with institutions in a unit of time, the better institutions we can create. The executive is very much a relic of monarchies, when the sovereign progressively shared power with the elected bodies. On the other hand, after reaching a certain critical size social structures tend either to split or to give rise to a centralized system of governance.

Political systems differ in their capacity to appropriate capital. The developments presented above suggest that appropriation of capital in the hands of public agents is based on the behaviour of private owners of capital rather than on fiscal policies as such. Political systems create a specific environment for the circulation and accumulation of capital. The basic intuition expressed originally by John Maynard Keynes, that governments can be active intermediaries in the allocation of capital, can be expressed even more categorically: governments are active intermediaries in allocating capital. Still, trends observable in the global economy over the last five decades suggest that public intermediation in capitalistic processes is declining. After having demonstrated, between 1950 and 1980, a strong capacity to redirect the flows of capital, political systems seem to be losing their grip in that respect. The logical next step of investigation is to study the trends of change in global capitalism.

Chapter 3

Changes in the ways that capitalism works

There are two distinct ways in which the term "capitalism" can be understood. The somehow colloquial meaning of the word refers to a distinctive economic system which is commonly opposed to feudalism or communism. That distinction seems to have its roots in the 19th century, when the breathtakingly fast technological progress, accompanied by considerable political turmoil, created an impression of a completely new social order emerging. Still, the very concept of capitalism as a distinctive economic system is somewhat blurred, when studied closely. Economists characterize economic systems as equilibriums, which it implies that no economic equilibrium can emerge out of a void. Adam Smith in his *Inquiry into the Nature and Causes of the Wealth of Nations* (Smith 2005 [1776]) demonstrated quite convincingly that consecutive equilibriums in the markets of goods, as well as in the market of loanable funds, can be traced as far back as to the 12th century, with much fewer sudden disruptions than a layman could arbitrarily assume. The reading of *Le Parfait Négociant*, a treaty about practical ways of doing business, published in 1675 by Jacques Savary, outlined business practices that basically do not differ from what is practised today. *Traité de la Circulation et du Crédit*, published in 1771 by Isaac de Pinto, demonstrated a grasp of public finance and fiscal policy quite similar to what governments do in the 21st century. Historical research proves that many systemic characteristics, commonly associated with "modern" capitalism, have been present in the European economy at least since the 14th century (see: Braudel 1983). On the other hand, some developments in the economic theory of property rights suggest that what we like to call "capitalism" is a distinctive characteristic of Western European and US institutional systems, rather than an epoch (De Soto 2000).

Social systems can be considered as technologies. If we assume – as it has been developed earlier in this book – that political systems can be regarded as technologies, whole social systems can be approached in the same manner. Thus, for the purpose of this book, the meaning of the word "capitalism" is very general and designates simply the ways in which people do business, i.e. the ways in which they accumulate and allocate valuable resources in order to produce socially appreciated outcomes.

With all the reservations as to considering capitalism as an epoch, there is certainly one characteristic of our present times that really matters for our current evaluations, namely the environmental challenges. The ways of doing business have always been functionally connected with the natural environment – one would never find much of a naval industry in Kazakhstan – and yet our modernity imposes a slightly different approach in that specific respect. For centuries, adapting business to natural environment has mostly meant exploiting the opportunities offered by Mother Nature such as fossil resources, waterways, etc. Today, we face an opposite challenge, that of fitting our ways of doing business into very tight limitations imposed by the natural environment. Hence, the overview of ways that modern capitalism works, presented in this book, starts with a glance upon of environmental challenges and then passes to more strictly economic phenomena.

3.1. Environmental challenges

The United Nations Environment Programme (UNEP 2016) alerts that, as a population, we are progressively reaching the limits of the planet's capacity. This is not even about our culture being so extraordinarily profuse. Our daily habits put at risk the resources we have at our disposal. Changing the lifestyles of individuals is one vital factor of survival for our species. Still, global coordination seems necessary. As the United Nations Environment Programme (UNEP) argues, it is crucial that governments and businesses implement policies that will guide people towards changing their lifestyles to more sustainable ones. The intuition behind this basic claim is that our lifestyles are both individual behaviours and social structures. The way we live means both the things we do as individuals and the socially imposed patterns of doing it. According to UNEP, a sustainable lifestyle *is a cluster of habits and patterns of behaviour embedded*

in a society and facilitated by institutions, norms and infrastructures that frame individual choice, in order to minimize the use of natural resources and generation of wastes, while supporting fairness and prosperity for all (UNEP 2016: 3). UNEP provides a growing evidence that lifestyles have a profound impact on our survival as a species, and the most influential lifestyles have the greatest impact. Probably THE lifestyle to address is that of a broadly understood, urban middle class: these people make the largest consuming segment of people in industrialized countries, and their lifestyle is the benchmark to follow for people in emerging economies and developing countries. The middle class on the planet, consisting of 1.8 billion individuals now, is likely to reach 4.9 billion in 2030 (Kharas 2011), and the aggregate demand for goods and services on their part could almost triple in value (Ernst & Young, 2011). The way in which we consume and use our resources is strongly influenced by structural factors: by the collectively determined access to certain goods and services – or the so-called facilitators – and by the available infrastructure. Both factors are, in turn, closely connected with public policies, e.g. subsidies, penal law, taxation, etc.

There is a theoretical current at the frontier of social and natural sciences, which has generated at least two important social theories, namely the evolutionary approaches in economics, sociology, psychology, etc., on the one hand, and ecology on the other. The ecological approach to social phenomena goes very much in the footsteps of Thomas Malthus, and sees social structures as a temporary and imperfect adaptation of collective human action to a given amount and availability of natural resources. Probably one of most prominent group of intellectuals professing those views is the so-called Club of Rome, an influential think-tank created in 1968, and one of their best known manifestos is the book entitled *The Limits to Growth* (Meadows et al. 1972). Their central thought is that human society generates positive feedback loops, i.e. patterns of collective behaviour which generate a growing output as they receive feedback on their previous output. Two such positive feedback loops are decisive for the workings of the industrial society: growth of population and growth of industrial capital. Mankind is confronted with limited resources of the planet, and from this point of view we live in a finite system. As positive feedback loops, with their exponential growth, collide with the frontiers of a finite system, negative feedback loops emerge, e.g. as we accumulate industrial waste, the cost of handling and recycling that waste becomes increasingly burdensome. Negative feedback loops

are observable with a delay: the negative consequences of colliding with the frontiers of growth appear significantly later than the actions that provoke them. Hence, we rarely know that our current actions actually generate a negative feedback from the environment. When we produce mineral water in plastic bottles, decades may pass before we truly face the drawbacks of those tons of plastic waste to be stored somewhere. To sum up, human societies systematically overshoot the sustainable level of their demographic size and industrial activity – we have a chronic tendency to be too many and to make too much of everything. At this point, the Club of Rome's manifesto enters into the same risky land of social self-limitation that once gave Thomas Malthus the opinion of being inhuman in his views. The Club of Rome advocates systematic self-restraining of both demographic and industrial growth in order not to have to invent temporary and highly imperfect methods of dealing with the negative outcomes of overshot growth. Instead of investing so much in new methods of treating industrial waste or in the humane treatment of big waves of migrants, let us limit the growth of the population and that of production. This is the modern expression of what Thomas Malthus called the "positive check of the population". The Club of Rome defines the global equilibrium as a state of things where the global society would be wholly sustainable, without the threat of sudden and uncontrollable collapse, and would satisfy the basic material requirements of all people. In order to achieve such a state of equilibrium, humanity should practise global policies of self-restriction. As for the demography, the negative feedback loops from the environment increase the death rate, usually in the poorest populations. The rational self-restriction proposed by the Club of Rome is systematic birth control, i.e. purposeful reduction of the birth rate. Demographic self-limitation is not enough, though. Formal models created by the Club of Rome in the early 1970s demonstrated that even if the global population came to a constant level and stopped there, uncontrolled accumulation of industrial capital, with zero demographic growth, would lead to an economic boom followed by a collapse. During the first 30–50 years after the demographic stabilization, industrial output per capita and food per capita would grow sharply up to a very high peak (reaching about five times the level before demographic stabilization) and create a state of temporary, and largely illusory, wealth. That explosive growth of industrial output per capita and food per capita would overexploit the natural resources of the planet. Past the peak of wealth, industrial output per capita and food per capita would plunge and after

another 30–50 years would reach a level slightly below the starting point (i.e. before the demographic stabilization). In other words, if we globally stabilize the population without controlling industrial capital, we are likely to land at the same level of economic wealth in some 100 years, only with significantly depleted natural resources: one seventh of their present amount (Meadows et al. 1972: 160).

Controlling the accumulation of industrial capital on the global scale means both the amount and the allocation. As for the amount, the Club of Rome modelled a state of things where industrial growth would occur in accordance with the classical Keynesian postulate of gross investment being rigorously equal to depreciation and in the conditions of constant population. In other words, null demographic growth would be accompanied by null net investment in plant, property and equipment. The introduction of that principle would lead, in 100 years, to a few improvements as compared with uncontrolled investment. Firstly, we would end up with slightly more natural resources: about one fifth of the present amount instead of one seventh. Secondly, we would have more food per capita, some 30% than before the starting point. Thirdly, industrial output per capita would ultimately fall to the same level as in the model with constant population and uncontrolled capitalistic accumulation. On the 100-year way to that ultimate state, we would also experience a sinusoidal change in food per capita and industrial output per capita, still in a much more moderate and gentler version, with the peak levels being around 200% of the present ones and remaining there for many decades (*ibidem*: 162).

Against those two scenarios, Donella H. Meadows et al. (*ibidem*: 163–166) set a third one, possibly the most optimistic and involving null demographic growth, null net investment in property, plant and equipment, as well as technological changes in the global economy. This path, called the global equilibrium, assumes that the supply of food per capita grows and stabilizes at about three times the present level for all people on Earth, industrial output per capita reaches some 150% of the present level and stays there, whilst the depletion of natural resources is largely slowed down and in 100 years we will have about 30% less natural resources than today. Technological progress leading to that state of equilibrium should make it possible to:

a) reduce by 75% the consumption of natural resources and the generation of pollution per unit of industrial output;
b) largely replace factory-produced material goods with immaterial services focused on health and education;

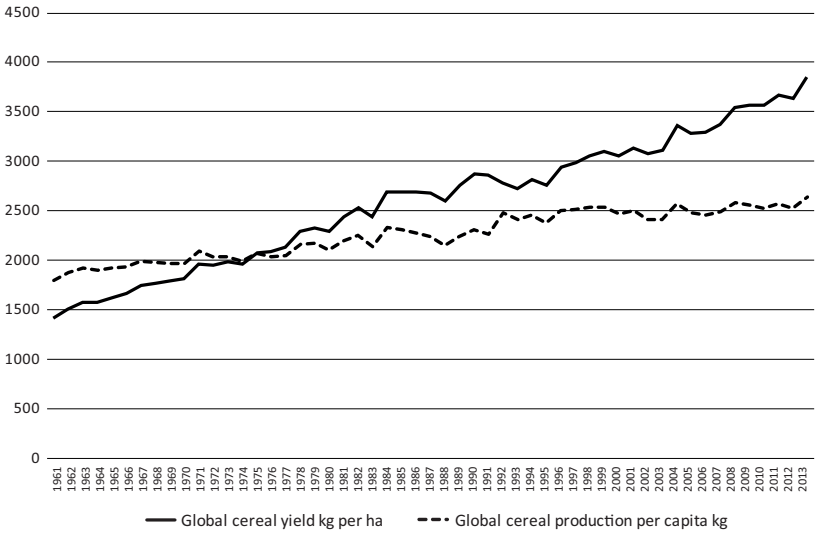

Figure 7. Global cereal yield per ha and global cereal production per capita
Source: World Bank.

c) shift industrial capital towards food production so as to produce enough food for all people and maximize the productive capacities of the soil through the recycling of urban waste;
d) prolong the average technological lifecycle of durable goods, both consumer goods and industrial equipment.

In the context of models developed in the 1970s by the Club of Rome, it is interesting to look at the current global trends in the relevant variables: population, food per capita and investment. The data published by the World Bank shows a progressive slowdown of the global demographic growth, from 2.04% in the early 1970s, when Meadows et al. released their model, to some 1.2% presently. The demographic growth is slowing down, whilst the supply of food and agricultural productivity keep growing, which is visible in Figure 7. The actual capacity to supply food grows at a slower pace than agricultural productivity. Most of the technological progress in agriculture brings other outcomes than just the capacity to feed the population.

Figure 2 indicates that the elasticity of food production to demographic growth keeps oscillating around 1, without going up or down. From this point of view, humanity seems to stay in the anteroom

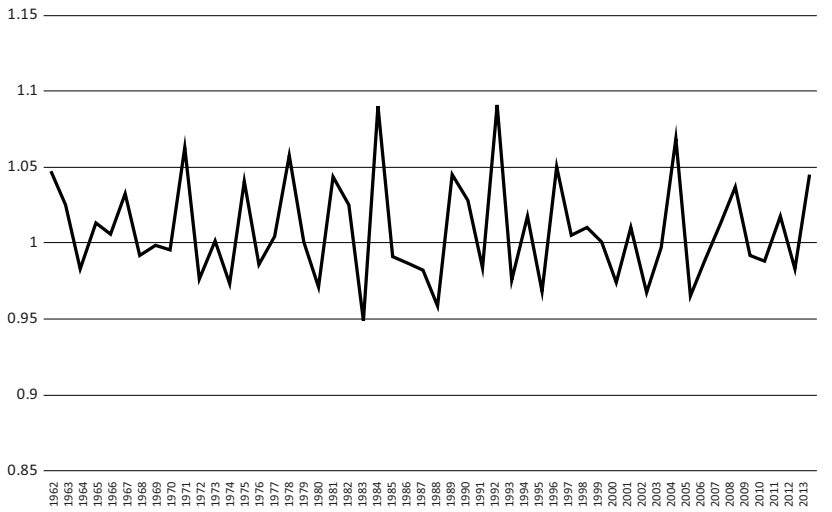

Figure 8. Elasticity of the total cereal production to population
Source: author's own elaboration based on the data published by the World Bank.

of a global alimentary crisis, yet without passing through the door of catastrophe.

In 2013, 41 years after *The Limits of Growth* was published, Paul R. Ehrlich and Anne H. Ehrlich from Stanford University published an article under the provocative title "Can a collapse of global civilization be avoided?" (Ehrlich & Ehrlich 2013). Ehrlich & Ehrlich claim that humanity is facing a new type of crisis: the global one. Any developed civilization in the past (e.g. Egypt, China, Maya) eventually experienced a more or less lasting collapse, and in some cases cyclical collapses in the form of a sudden decomposition of the social structure accompanied by a dramatic demographic decline. Currently, humanity as a whole is facing the threat of such a collapse. Citing other researchers (Wackernagel, Rees 1996), Ehrlich & Ehrlich stated the basic assumption: given the current state of technology and social organization, the Earth is overpopulated. The present population of 7.35 billion people requires at least half an additional planet to lead a sustainable existence. If the consumption of resources by those 7.35 billion people were to reach the level per capita of the United States, four to five more planets would be needed. The main threats listed by Ehrlich & Ehrlich include: climate change,

global toxification resulting from pollution, loss and degradation of arable land, barriers to agricultural productivity and its inherent conflict with biodiversity. The originality of Ehrlich & Ehrlich's approach is that they are quite sceptical as to role to be played by technological innovation, and moderately optimistic as to the impact of social organization, which they understand mostly as a more efficient resource allocation. Ehrlich & Ehrlich stressed that any social institution derives its salient points from the biological properties of *homo sapiens*. As a species, we are programmed to react mostly to the immediate threats and opportunities in our environment, much more than for long-range planning and pre-emptive avoidance of dangers. Thus, social organization that could possibly save us from a global collapse of the civilization requires a radical rethinking and relearning of the fundamental patterns in our behaviour. Procreative patterns are essential: as a civilization, we should do anything possible to avoid passing the threshold of 9 billion people on Earth and start a decline below the present level of 7.35 billion. Full rights, as well as education and social opportunities for women, combined with modern contraception and backup abortion, give strong chances of success in reducing fertility rates to reach those demographic targets.

As agricultural output and supply of food are one of the key challenges, proper allocation of capital in the global economy seems to be one of the cornerstones of positive change. In order to grasp that aspect of social reality, the concept of elasticity, an old friend of any economist, can be used. If one phenomenon is supposed to produce change in another phenomenon and both are measurable on continuous scales, a ratio of elasticity between them can be calculated. We take the magnitude of change (the so-called "delta") of the variable supposed to be elastic and divide it by the magnitude of change in the variable supposed to cause the change. The resulting ratio is the coefficient of elasticity. Elasticity in that form is calculated for just one point in space-time. More points can be observed and their respective elasticities assessed. The tendencies observable in such a set of elasticities are informative about the functional link between the phenomena in question. Figure 9 shows the elasticity of cereal production per capita in the global economy (World Bank data), with respect to the accumulation of fixed amortizable assets, or the delta of the fixed capital stock (Penn Tables 8.1), between 1962 and 2011 (Feenstra et. al. 2015). The general look of the trend is that of lack of any trend. The elasticity of cereal production per capita to the accumulation of fixed capital seems unstable, and still it is getting more unstable with time. After

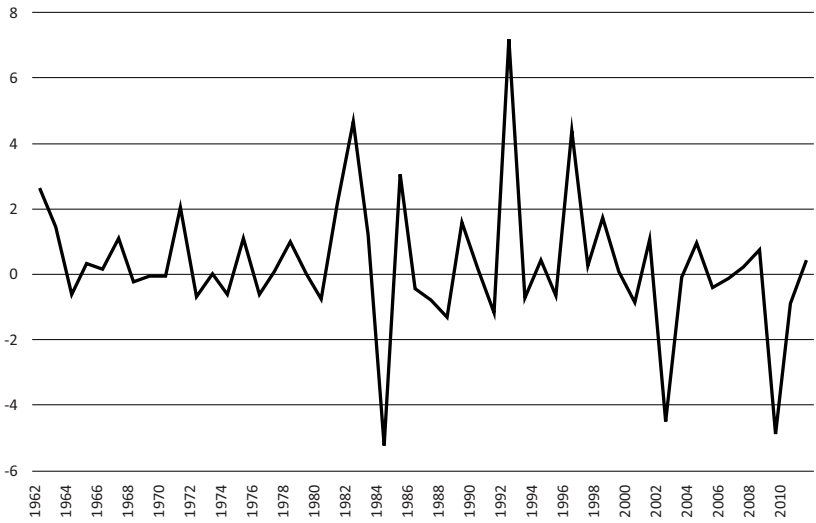

Figure 9. Elasticity of cereal production per capita to the accumulation of fixed amortizable assets per capita
Source: author's own elaboration based on the data available at www.worldbank.org and in Penn Tables 8.1.

1980, the elasticity of food supply to the accumulation of fixed amortizable assets started to oscillate within a much broader interval than between 1962 and 1980. Such an accentuated oscillating movement shows an uncertainty of outcomes which, in turn, is a symptom of change. Something is changing in the global allocation of capital. With every consecutive year, the impact of productive investment upon the capacity to feed humanity becomes more and more uncertain. Capitalism is changing.

As we are facing global threats, as a civilization, the way in which we use and accumulate capital is essential to our survival. Whether we want it or not, we are economic in our social life and our social structures are very strongly, and increasingly, capitalistic (the latter can be judged by the amount of fixed amortizable assets per capita). Changes in the modalities of capitalistic activity are crucial to social changes in general and to the possible transformations in the political structures. The structure of capitalism as a whole can be very much approached as a balance sheet, with its characteristic cross-cutting proportions, such as the proportion between debt and equity, the turnover of assets and their

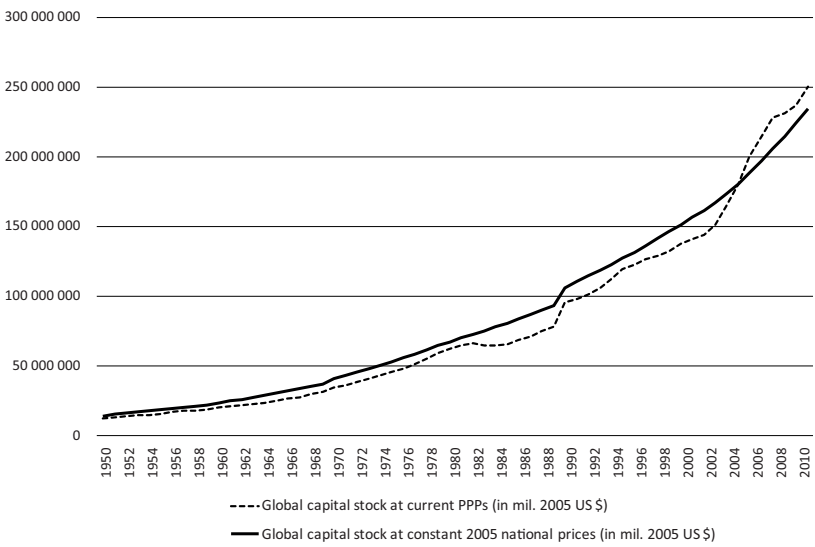

Figure 10. Global capital stock
Source: Penn Tables.

liquidity, etc. Of course, on the global scale such a comparison is necessarily burdened with a considerable error: for example, different countries report their capital aggregates according to different methodologies. Nevertheless, any clear, sharp trend can be informative.

3.2. Accumulation and depreciation of capital stock in the global economy

Figure 10 shows the evolution of the global capital stock as computed in Penn Tables 8.1 (Feenstra et al. 2015). This is the amount of amortizable fixed assets present in 167 countries covered by the Penn Tables 8.1 database. The graph uses constant 2005 US dollars, and two alternative computations are provided: at current PPPs and at constant national prices for 2005. The latter can be considered as a smoothed version of the former. Without reference to fluctuations in the local markets of goods, and at constant national prices 2005, the global stock of amortizable fixed assets in 2011 was more than 16 times bigger than in 1950 and 2.2 times

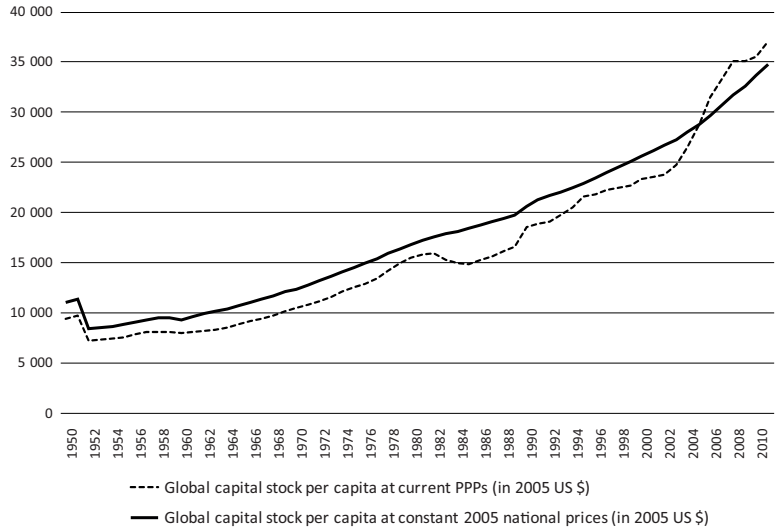

Figure 11. Global capital stock per capita
Source: Penn Tables.

bigger than in 1990. Thus, we are very far from the postulates of Meadows et al. Of course, during the period covered by the diagram, the world has changed. The observable growth in the fixed, amortizable capital stock took place in the context of demographic and economic growth. As for the former, Figure 11 gives an idea of the global capital stock per capita computed as the ratios of each of the two capital aggregates divided by the global population. As it can be observed, both ratios display a spectacular growth over the period since 1950 until 2011. As one compares those two trends: capital per capita and food supply per capita, the former follows a much steeper slope than the latter.

Accumulation of the fixed capital stock, as reported in Penn Tables 8.1, is net accumulation, i.e. gross investment diminished by the rate of depreciation. The latter shows the pace at which our fixed productive assets lose their value in time. Figure 12 shows the curve of the global depreciation rate for the fixed assets accumulated in 167 countries covered by the database, between 1951 and 2011. The curve follows a gentle but visible trend upwards: the fixed amortizable assets accumulated in the global economy have a shortening life cycle and become obsolete at

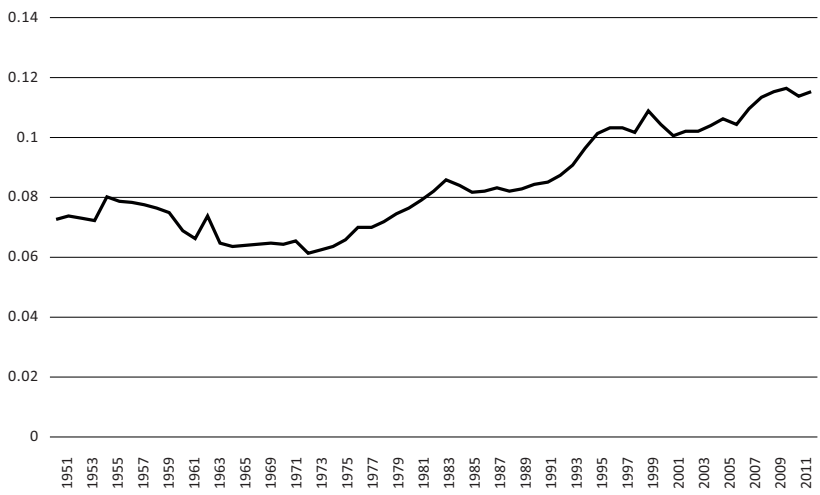

Figure 12. Average rate of depreciation
in the fixed amortizable assets of the global economy
Source: Penn Tables.

an increasing pace. The change seems quite gentle and still, if we compare the average rate of depreciation in, for example, 1955, with that observable in 2011, the proportion is 1:2. Today, our fixed amortizable assets get obsolete twice as fast as they used to six decades earlier.

The phenomenon of accelerated depreciation is probably due to a faster technological race as the main factor. From that point of view, one could say: the rate of depreciation is the double of what it used to be in the 1950s... Cool! It means that today our technologies are developing twice as fast. Indeed, this is true: a faster depreciation can be a sign of a faster technological progress. However, there is the flipside of the coin. The intuitive concept of depreciation has its source in farming. Soil needs fertilizing and maintenance in order to keep its productive capacities. The poorer the original, geologically given content of nutrients in the soil, the more frequently we have to fertilize. Intense agricultural production frequently leads to a state in which, without constant fertilization, the soil can produce barely any harvest. In other words, we have to supply to the soil nearly all the nutritive value that we expect to harvest, and the soil itself is just some kind of a mechanical structure supposed to channel nutrients from fertilizers into the vegetal substance. This is the limit of productivity in agriculture, where farming becomes

a strictly industrial process and has no actual base in the ecosystem. Returning to the amortization of the fixed assets, that growing rate of depreciation means that more and more capital is required only to keep the engine running, so to speak. Capitalism needs more and more effort to maintain its own structure, which means, in turn, that social structures known as "capitalistic" are progressively running against a limit of their capacity to organize collective human effort.

3.3. The velocity of money

Here, another piece of empirical data comes as an interesting observation: the velocity of money. The monetarist theory in economics postulates the existence of a meaningful, structural proportion between the supply of money from financial markets and the real output of the economy. The value of that output, divided by the supply of money, yields a ratio indicating how many times each unit of currency makes a full turn within the economic system. The World Bank data on the supply of money, combined with those about global output, allows for the calculation of the velocity of money on the global scale. The corresponding trend between 1960 and 2011 is visualized in Figure 13: the global velocity of money is steadily decreasing. Money circulates at a decreasing pace in the economic system of our civilization. In the spirit of monetarists, we can say that money works with a decreasing efficiency and, as a social contrivance, offers a diminishing amount of services to its holders. This is not just about cash or material money This is about broad money, credit cards and term deposits included. Money in any form becomes less and less useful. When money is hoarded (e.g. in the form of long-term deposits), it circulates at a slower pace: its velocity decreases. Money hoarding is strongly associated with social inequalities. If someone has barely enough money to finance the most urgent current expenses, there is nothing that can be hoarded. Only those endowed with large surpluses of cash can afford to build substantial reserves. The recently observed phenomenon of global deflation seems to confirm that intuitive link between social inequalities and the decreasing velocity of money. The global economy is displaying global deflationary trends, i.e. the prices of many goods and raw materials fall instead of go up. When the price of any good, expressed in monetary units, decreases, the value of one monetary unit stands for an increasing chunk of utility embodied in economic

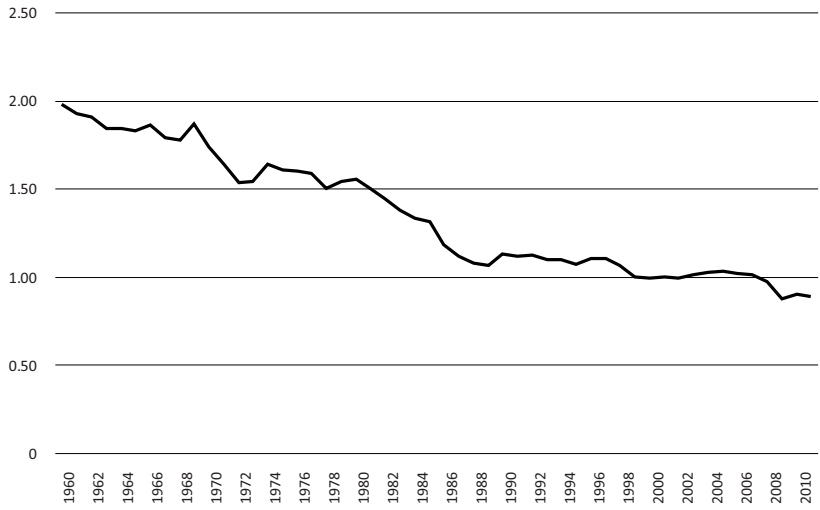

Figure 13. Velocity of broad money in the global economy
Source: author's own elaboration based on the data available at www.worldbank.org and in Penn Tables 8.1.

goods. The exchange value of money increases in relation to things we can buy with it. That suggests that the amount of money in circulation grows at a slower pace, or even decreases, in the presence of a growing output and consumption of goods. If a growing portion of money officially present in the economy is hoarded, e.g. in the form of long-term deposits, such a phenomenon can happen.

This is something new. Practically the whole international economic order established after the Second World War was structured so as to contain inflation. The diminishing velocity of money suggests its diminishing usefulness, and therefore its diminishing value. Less value in each unit of money means less purchasing power, higher prices and inflation. That has all been logically linked up to a point. With deflation stepping into the scene, the landscape changes radically, and we face a paradox. Money is losing its usefulness, but gaining purchasing power.

Money on the global scale is mostly immaterial. Any significant amount of money (i.e. anything more than a handful of metal coins) represents a set of standardized claims on banks. The currency in circulation, or "hard cash", is a set of claims on central (national) banks. The balance available on a bank account is a claim on the commercial bank

in question. Much more money is available as immaterial balances on accounts in commercial banks than there is hard cash in circulation, because commercial banks lend and borrow money much more swiftly than they settle their accounts with central banks. Most of the money available exists de facto as the residual difference between the speed of transactions in and between commercial banks on the one hand, and the speed of settlements between commercial banks and central banks on the other. The majority of the so-called monetary economy exists just because there is such a difference in the speed of transactions. There is strong historical evidence that immaterial money (i.e. most of the money actually supplied in the economic system) was created as a system of standardized units of measurement in the settling of commercial accounts many centuries ago (Braudel 1981: 464–468). When information about the values being due in commercial transactions travels faster than the goods being traded – and it usually travelled much faster – some system of account settlement is needed, which requires a relevant arithmetic. That is how monetary balances arise: as the summing up of accounts to settle. To settle, not being settled at this very moment. The difference between the amount due to pay and the amount currently changing hands creates the monetary balance on account.

It is possible to connect the two dots now: the changes in the role of banks lending to finance global assets and the changes in the velocity of money. The banking sector grows faster than the fixed assets materialized in productive assets, whilst the main product of the banking sector, namely money, becomes less useful and more hoarded. Banking can be compared to a huge factory which accumulates more and more capital in order to produce goods that are less and less demanded, and at the same time more and more stored in safe vaults. This is a well-known syndrome of "running against a brick wall investment". Having grown up in a communist country (Poland), the author of the present book knows that syndrome from his actual experience. When a project grows big, our hopes grow even bigger. When the project starts to falter, we frequently refuse to acknowledge that our hopes were greatly overshot. That refusal is active. "You think the ship is sinking? Well, if we invest much more, you will see that you will not think anymore that it is sinking!" As absurd as this train of thought seems to a bystander, it is frequently the case, both in the corporate world and in public policies.

There is a dangerous beast that haunts the peaceful dreams of bank executives: the defaulting borrower. Someone who does not pay back as

due. In "elegant" economics, such loans, due from defaulting borrowers, are called "non-performing". The relative weight of non-performing loans in the total mass of credit is a strategic variable for any bank. It is the outcome of the risks taken by bankers in selling credit as a good. It is also an indicator of financial stability in the economic environment a given bank is operating in. It is a factor of solvency in the bank itself and of the actual commercial interest rate: someone has to pay for those who do not pay and that "someone" are other customers. The World Bank publishes data about non-performing loans in the banking sector as a percentage of the total mass of credit. As one has a closer look at the data, the earliest dates from 1997 (!), and systematic time series for the world economy date back to 1999. We have data about agricultural yield per hectare back to 1961, but we have publicly disclosed data about defaulting loans only since 1997 – is that not interesting? That shows how sensitive this information is for bankers. As a matter of fact, that ratio of non-performing loans to the gross mass of loans granted is an excellent indicator of how efficiently the banking sector works. It shows the rationality in risk taking, it shows the accuracy of judgement in relation to the economic environment, it reflects the well-founded human resource policies inside banks when it comes to hire people for the front office, it gives feedback on the rationale of bundling credit with insurance, etc. In short, the ratio of non-performing loans shows how well banks adapt to their social environment. Table 9 shows the time series of that indicator published by the World Bank for the whole global banking system. We can see a peak in 2000 and 2001, when the ratio reached 9.7%. Interestingly enough, it was exactly the moment when the global trend in the "debt to equity ratio", discussed previously, curbed and reversed from ascending to descending. Between 2000 and 2008, the ratio of non-performing loans followed a descending trend, which reversed again in 2008, when the global financial crisis reached its peak. Once more, the trend of the "debt to equity" ratio in the global assets followed exactly the same trajectory: it reversed from descending to ascending. Since 2008, the non-performing loans have grown in importance.

When relating the data about the "debt to equity" ratio in the global economy with those on non-performing loans, a first tentative conclusion can be made about capitalism in general: around 2000, the global banking system reached a temporary limit of inefficiency and volume measured in capital terms. Since then, banks have kept on experimenting, but it seems that the long-term trend is towards the deflating of the banking

Table 9. Bank non-performing loans to total gross loans (%) in the world economy

Year	Bank non-performing loans to total gross loans (%) in the world economy	Year	Bank non-performing loans to total gross loans (%) in the world economy
1999	9.0	2007	2.7
2000	9.7	2008	3.0
2001	9.6	2009	4.2
2002	8.3	2010	4.0
2003	6.7	2011	3.9
2004	5.2	2012	3.7
2005	3.9	2013	4.1
2006	3.1	2014	4.1
		2015	4.3

Source: World Bank.

sector in the financial terms (less capital invested in the equity of banks). At the same time, the role of the banking system is changing, from being a facilitator of swift exchange to a depositor of value.

The velocity of money and the relative importance of the banking system in the global economy are related to trade. The discrepancy between the speed that the goods traded and the information about transactions travel at naturally privileges banks as financial intermediaries in international trade. Here, another interesting fact appears: the correlation between the global trade and the global production is changing. As the World Trade Organization reports it (WTO 2016), for many years the overall dynamic of trade has been connected with the global economic growth in roughly a two-to-one proportion. Yet, since 2012, that proportion seems to have broken down: recently, trade has been growing at around the same rate as global output. That "income elasticity of trade" reached its peak in the 1990s and has followed a descending trend since then. At the same time, the share of trade in the global output remains record-high. It is possible to imagine that the intensity of trading activities in relation to global economic life has reached a temporary ceiling. A flurry of the so-called "trade facilitation" initiatives have emerged in response. The Trade Facilitation Agreement, signed under the auspices of the World

Trade Organization, is an excellent example. The Transatlantic Trade and Investment Partnership, or TTIP, a quasi-mythical monster by now, is another one. The theory behind those initiatives claims that trade is being throttled by excessive formalities at national borders, which, in turn, cause excessive transaction costs. The abolition of at least some of those formalities should lower the costs of trading and give a boost to international exchange. The debate about trade facilitation agreements is a theatre of heated argument: the fervent partisans oppose the harsh critics. Statements about "bringing the world economy up to a new speed" are countered with claims about "capitalistic attempts to subduing the democratic order". Whatever one thinks about trade facilitation agreements, one central fact is undeniable: constitutional states, with their national borders and exclusive sovereignty, are becoming a nuisance to big business, after many decades of having been a supporting force. It is not accidental that global capitalism experienced a sharp growth on the wave of decolonization, or that the sovereign debt issued by governments has for a long time been the safest financial placement, as compared to equity in actual business. Business likes a reasonable level of predictability and peace, and the really big business likes silence. Constitutional states can offer both. The principle of national sovereignty is the basis of international agreements which create a solid ground for international business ventures. The steady solvency of most governments creates a temporary harbour for investors exhausted with the hurricanes of business cycles. The magical expression, "national security", gives an excellent excuse to negotiate important business matters (meaning: important to the average citizen, like the price of curing breast cancer, for example) in the velvet calm of ministerial offices. Constitutional governments and capitalism can indeed contra dance together, but a discord seems to be present in that dance. Further in this chapter, we are going to return to that aspect of social changes, but now we let us return to the recurrent phenomenon of the decreasing velocity of money in the global economy.

So far, the presented exploration of that trend has followed the intuition of classical economics, probably dating back to the Austrian school and the writings of Carl Menger, who claimed that: *Money has not been generated by law. In its origin it is a social, and not a state institution. Sanction by the authority of the state is a notion alien to it. On the other hand, however, by state recognition and state regulation, this social institution of money has been perfected and adjusted to the manifold and varying needs of an evolving commerce, just as customary rights have been perfected and adjusted*

by statute law (Menger 1892). It is the view of money as an institution. However, a distinct intuition has emerged in social sciences, even before they detached themselves from philosophy, namely that money is a social force in itself, that it can shape social reality by its sole presence and movement. It is the mercantilist view, presented in many forms by many social thinkers. Interestingly, the practitioners of business used to see money exactly in this way, whilst the theoreticians used to follow the interpretation of classical economics. A classical comparison in that respect is that between the views of Adam Smith, a philosopher who never did any actual business, and those expressed by Isaac de Pinto, a Dutch financier. Those two writers published their books almost at the same time. In 1771, Isaac de Pinto published (in Amsterdam) his book entitled *The Treaty of Circulation and Credit* (original title: *Traité de la circulation et du crédit*). He advocated very active financial policies on the part of governments, and praised the issuance of sovereign debt as a way to revive the economy and stimulate trade. In 1776, Adam Smith published his *Inquiry Into The Nature and Causes of The Wealth of Nations*, and claimed that bank money, as opposed to minted metal money, is rather a fashionable folly of the financiers. Eventually, it was Adam Smith's view that prevailed in social sciences, while Isaac de Pinto remained known only to those really interested in old writings. Still, we can try to apply his views to the modern society and, for a moment, consider **money as an autonomous social force**. Force equals mass multiplied by momentum. Thus, if we multiply the supply of money by the rate of change in its velocity, we can roughly calculate the resulting amount of social force. Figure 14, below, presents a tentative, graphical illustration of the corresponding trend between 1963 and 2011. The curve jumps up and down and, apparently, hardly any definitive direction can be traced in its trajectory. Yet, one thing is undeniable: the amplitude of those leaps increases. Increased amplitude of change in time means higher uncertainty. Another, less obvious pattern is visible, too: the downturns become more and pronounced than the upturns. Following a swinging movement, money is losing its social power. Figure 14 brings into mind an earlier one, namely one presenting the elasticity of cereal production per capita in the global economy with respect to the accumulation of fixed amortizable assets, or the delta of the fixed capital stock. Both follow the same, sharply swinging pattern. Another tentative conclusion can be formulated about the changes in the capitalistic society: the connection between investment and production of food is weakening and is burdened with growing uncertainty, as the social force of money is weakening and losing predictability, too.

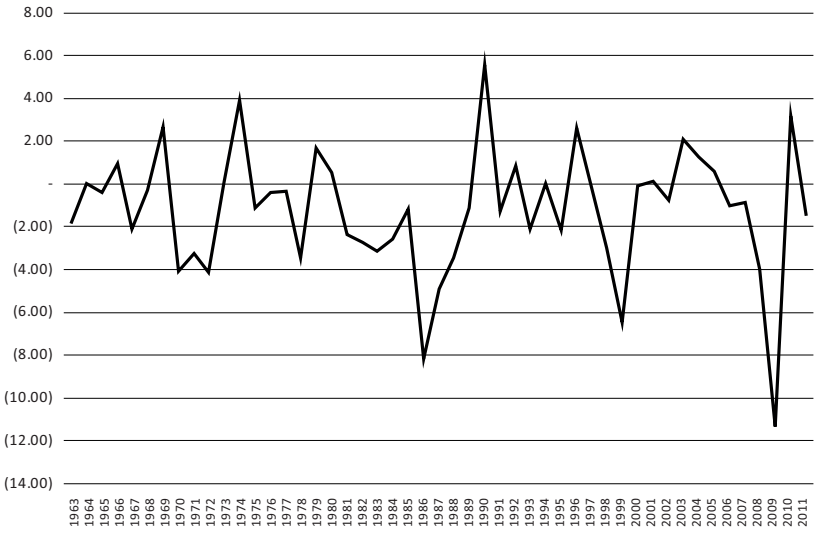

Figure 14. The social force of money
Source: author's own elaboration based on of the data available at www.worldbank.org and in Penn Tables 8.1.

The attempt to represent the social role of money in terms of social force brings into mind an article published in 1958 by Paul Samuelson, the first American economist to receive the Nobel Prize in economics (Samuelson 1958). Samuelson tackled the general issue of predicting future interest rates on capital, a topic of vital importance to the professionals of finance and theoreticians. He started with a general question: what should be the curve of interest rate over time if that interest rate was to participate in the general equilibrium (i.e. in a state of things when all the productive resources are fully and optimally employed), in a perfect capital market endowed with perfect certainty? In other words: if we eliminate all gaming, gambling, insider trading, swindling and cheating from the capital market (perfect certainty in a perfect market), what would be the interest rate in an economically optimal state? Paul Samuelson started with assuming that the main social function of money is to transport value and wealth over time rather than in space. This approach seems somehow counterintuitive at first sight, but Samuelson was quite firm on that point: if we are much more interested in interest rates and price volatility than in the velocity of money, we care much more about how money

works in time than in space. Samuelson formulated a general theorem stating that every geometrically growing consumption – loan economy has an equilibrium market rate of interest exactly equal to its biological percentage growth rate. In other words, the economic theory existing in the 1950s (when the article in question was written) looked at the social role of money as a thing (or a good in itself) rather than an abstract medium of exchange. Presently, the social force of money decreases, as the rate of demographic growth decreases, too.

Paul Samuelson made another assumption in his article, yet it was not called explicitly an assumption and consisted in studying the social role that money plays for the working class rather than for capitalists. This is understandable: most of the working class are people whose current income is very clearly divided into current consumption and saving. Tracing the path of money inside the social structures formed by people earning their living by work is relatively simple. Capitalistic circuits of money are much more convoluted and obscure. As limiting as this implicit assumption could seem, observable facts confirm the general contention that the social force of money is tightly knit to the change in the population.

The notion of money as an autonomous social force might seem too far-fetched. Still, an astonishing connection to energy in the strict sense appears. The data about the velocity of money in the global economy can be combined with the information about energy intensity and, more exactly, with the World Bank-published variable "energy use per capita", expressed in kg of oil equivalent per capita. This variable refers to the use of primary energy before transformation to other end-use fuels, which is equal to indigenous production plus imports and stock changes, minus exports and fuels supplied to ships and aircraft engaged in international transport. Table 10 shows the velocity of money conjointly with energy use per capita in the global economy, both indexed as the constant base of their respective values in 2000. As those two indexes are juxtaposed, a clear inverse correlation appears between them. As the velocity of money decreases, energy use per capita increases. As strange and "non-monetarist" as it might appear, there seems to be some kind of pattern in the global economy, which makes it demand more and more money in relation to the current output, as we use more and more energy per person. There seems to be very strong grounds indeed for considering money as a social force, as its velocity seems to be correlated with the basic physical forces that we harness and use in our civilization.

Table 10. Energy use per capita and velocity of money, indexed, in the global economy

Year	Energy use per capita in the global economy, index 2000 = 1.00	Velocity of money in the global economy, index 2000 = 1.0	Year	Energy use per capita in the global economy, index 2000 = 1.00	Velocity of money in the global economy, index 2000 = 1.0
1971	0.82	1.61	1993	0.98	1.10
1972	0.84	1.51	1994	0.97	1.10
1973	0.86	1.51	1995	0.98	1.08
1974	0.85	1.60	1996	1.00	1.11
1975	0.83	1.57	1997	0.99	1.11
1976	0.87	1.55	1998	0.98	1.07
1977	0.88	1.54	1999	0.99	1.00
1978	0.90	1.46	2000	1.00	1.00
1979	0.91	1.50	2001	1.00	1.00
1980	0.89	1.52	2002	1.00	0.99
1981	0.86	1.46	2003	1.03	1.01
1982	0.84	1.43	2004	1.06	1.02
1983	0.84	1.38	2005	1.07	1.03
1984	0.86	1.33	2006	1.09	0.99
1985	0.86	1.31	2007	1.10	0.98
1986	0.86	1.18	2008	1.10	0.94
1987	0.88	1.12	2009	1.08	0.88
1988	0.90	1.08	2010	1.13	0.90
1989	0.90	1.06	2011	1.13	0.89
1990	1.01	1.13	2012	1.14	0.87
1991	1.01	1.11	2013	1.16	0.87
1992	0.99	1.12			

Source: World Bank.

3.4. The velocity of money and financial markets

At this point, a strong claim is made, central to the present book: our current social structures, capitalistic and political structures included, are essentially adapted to a relatively quick demographic growth in the conditions of relatively abundant natural resources and relatively ample space to live in. The situation is changing, though, and mankind is facing an opposite challenge: demographic growth is slowing down, and we are very close to the limits of capacity offered by the ecosystem. Our social structures are becoming obsolete, and obsolescence means the necessity to innovate. Innovation requires experimentation: the emergence of new, more efficient social structures necessarily implies social instability. Is it equivalent to claiming "the collapse of capitalism"? A cautious answer is: not necessarily, and not obviously.

Sumerians had such a system, so as did ancient Greeks and pre-Colombian Incas, and so we do today. There is no evidence to support the claim that the builders of Machu Picchu were more capitalistic or less capitalistic in their social structures than we are today. The human society in 200 years from now will probably have a capitalism of its own, different from the present one, yet still a capitalism. Some authors argue (Rifkin 2014) that our present social order is obsessed with the idea of exclusive, private property rights. Still, facts contradict somehow that contention. Most money to make in terms of return on investment is to be found in the world of financial markets – securities, derivatives, futures contracts – and these are anything but clear in terms of private property rights. Financial rights have many degrees of substitution and derivation, and temporary possession of those rights brings more profits than permanent and exclusive property. The market of securities has substantially developed since the Second World War and yet, as Figure 15 shows, the essential socio-economic function of listed securities seems to be very much that of money. Figure 15 combines two ratios, informative in that respect. The dotted line marked with rectangles represents the global market capitalization of listed domestic companies in proportion to the global GDP, as published by the World Bank. The blue continuous line relates the same market capitalization to the supply of broad money. Both time series cover the period 1975–2011, and both curves follow an astonishingly similar trajectory, as if the markets of corporate securities had no other function than the monetary one. Since about 1999, the capital market (i.e. the capitalization of corporate securities) seems to withdraw

from the economy. That withdrawal occurs through leaps and bounds, yet it is visible. Figures 16 and 17 explore this path of observation. Figure 16 compares the velocity of broad money in the global economy to the velocity of listed corporate securities between 1975 and 2011. In the long run, both velocities follow the same descending trend, yet some differences can be noticed. In the 1970s, the velocity of corporate securities was much higher than the velocity of money, but since then it has followed a much steeper descent until bouncing against the velocity that money has. Capital markets appear as a social device serving to speed up economic exchange, although the surrounding social structures seem to have been sticky enough to slow down the mechanism. Figure 17 combines the data from the World Bank with those provided in Penn Tables 8.1 and denominates, respectively, the supply of credit from the banking sector and the market capitalization of listed companies in units of the fixed capital stock (i.e. both financial aggregates are shown as ratios to the available capital stock). In that case, two different patterns can be noticed. The supply of credit grows consistently in relation to the stock of fixed amortizable assets, whilst the capitalization of corporate securities seems to follow some kind of a life-cycle, dome-shaped curve, with a peak around the year 1999. On the other hand, the capital market has never reached the relative importance of bank credit in financing fixed assets of the global economy.

Piketty and Zucman shed some light on the decreasing velocity of money in the global economy (Piketty, Zucman 2014). Their research concerning the wealth-income ratios in developed countries between 1700 and 2010 indicates that rich countries experienced an unusual liquidity of capital after the Second World War or, in other words, an unusually low levels in the ratio of current income divided by capital. Whilst during the post-war decades the wealth-income ratio approximated 200–300% until the 1970s, the historically recurrent value is rather around 600–700%. More capital accumulated in relation to current income means more capital stored in fixed assets and less capital circulating. It should be kept in mind, in this context, that the overall employment of money supplied in the economic system is strongly connected with the structure of assets, and the structure of those assets can be much more finely sliced beyond the basic distinction into the fixed assets and the circulating ones. The category known as "plant, property and equipment" is a good example. It covers both land with an almost indefinite life cycle, buildings endowed with a cycle of exploitation stretching over many

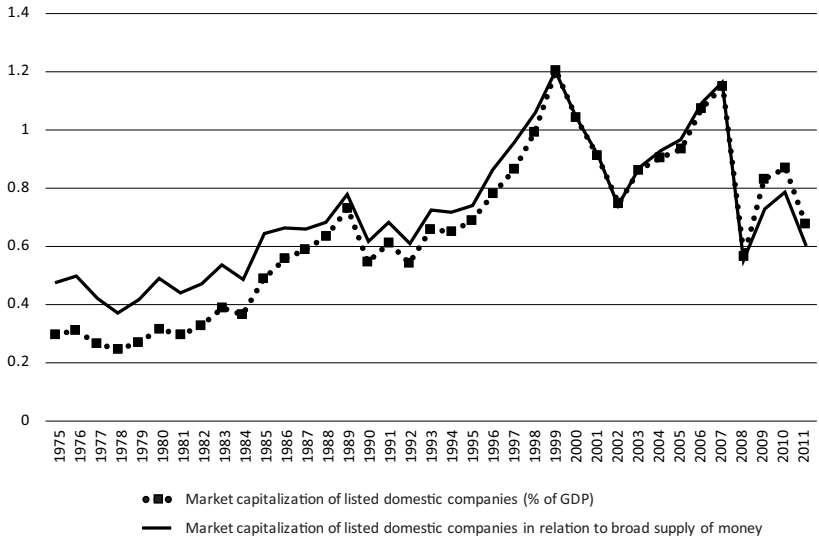

Figure 15. Market capitalization of listed domestic companies in the global economy
Source: World Bank.

decades, and machines which, in the presence of a relatively intense technological race, might need changing after five years or even sooner. Depending on the exact structure of the "plant, property and equipment" category, the capital invested in the balance sheet might have a cycle of turnover ranging from five years anywhere to 50 years or more. Here comes a principle well known to most entrepreneurs: with the exception of some windfall gains, the slower the pace of circulation of our assets, the lower the rate of return on them. That seems to be the case in developed countries, according to Piketty and Zucman: the average return on private wealth, although varying strongly over decades, seems to follow a generally descending trend over the last century. We are facing a systematic freezing of capital in assets with a rather slow cycle of exploitation. Yet, there is an interesting piece of evidence that Piketty and Zucman bring forth, and which seems to contradict somehow that general trend: the rate of return on capital decreases at a slower pace than the capital accumulates. According to the basic law of diminishing returns, as capital accumulates, the average return on it should decrease accordingly. With the strict application of the classical Cobb-Douglas production function, there should be a nearly linear proportion between the accumulation

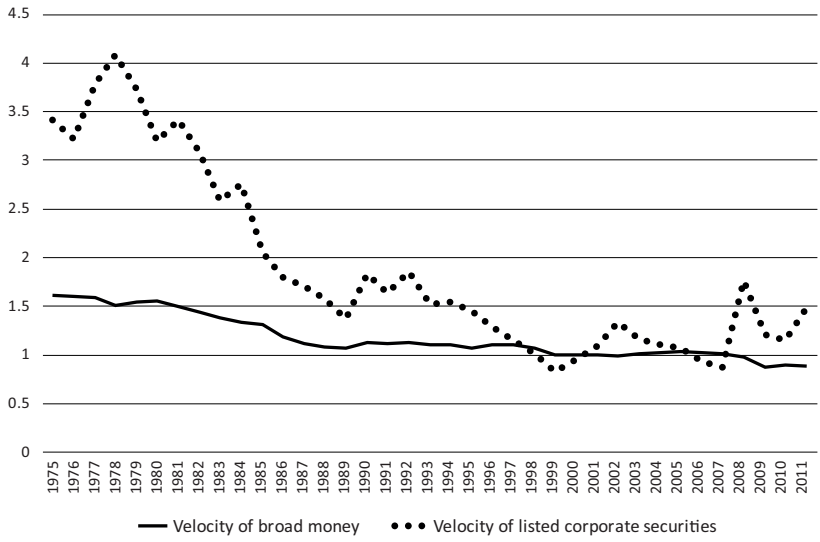

Figure 16. Velocity of money compared to the velocity of listed corporate securities
Source: author's own elaboration based on the data provided by the World Bank and Penn Tables 8.1.

of capital and its diminishing capacity of bringing income to its owners. Yet, the marginal productivity of capital in the developed economies seems to be slightly higher than this basic model would suggest. Capitalism is learning to invest more productively, although that learning seems to be much slower than any theory of management could suggest.

A tentative conclusion can be formulated about the changes that global capitalism is undergoing. First of all, global capitalism is increasingly a hoarding, money-in-the-mattress-oriented system, with a marked distaste for financial circulation. Something in our social structures seems to slow down any financial institutions designed to stimulate the flow of capital. Institutions essentially devoted to making money circulate, namely banks, seem to be increasingly ill-adapted to carry out that fundamental mission. Whilst financial circulation slows down, accumulation of fixed assets speeds up. As a global economy, we show a tendency to accumulate assets rather than develop systems of exchange. If social structures are to be considered, following the distinction made by the French historians, as a combination of networks and hierarchies, the global economy seems to become more and more hierarchical, with a relative loss of its networking

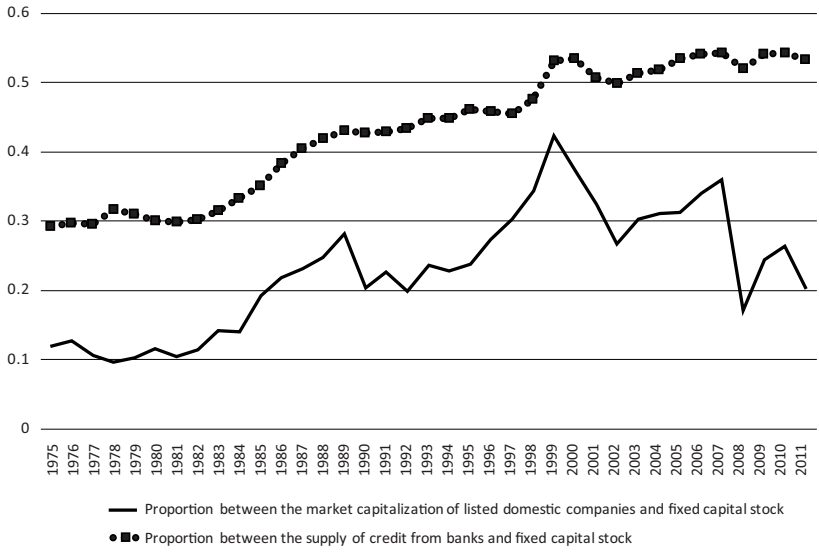

Figure 17. Market capitalization of listed companies compared to the fixed capital stock, in the global economy
Source: World Bank; Penn Tables 8.1.

capacity. Using an organic metaphor, global economy seems to be waiting for something. That state of things brings into mind two economic theories, incidentally created at virtually the same moment: the theory of business cycles by Joseph A. Schumpeter (Schumpeter 1939) and that of John Maynard Keynes (Keynes 2007 [1935]). In his view of business cycles, Schumpeter described a specific phase which occurs between big waves of innovation: the entrepreneurs have basically exploited all the business opportunities emerging from a given set of technologies and are waiting for something new to happen. In that waiting process, they progressively repay their loans, withdraw some operations from public capital markets and accumulate assets with low risk. The Schumpeterian theory was formulated before the Second World War, and many could say that here is an old cow that we had better not milk again. Still, an interesting fact arises from studies published by the World Development Report 2016 (IBRD / World Bank 2016): the social phenomenon that we call the "digital revolution" is, in fact, a diffusion rather than a technological revolution in the strict sense, as economic gains do not follow the spreading of technologies. The previous World Development Report (IBRD / World

Bank 2015) demonstrated quite convincingly that the social structures we live in hide in them an enormous and unexploited potential for learning and change. Pockets of inefficiency in social learning are present in virtually all societies. Putting together those two reports, an interesting conclusion emerges: digital technologies seem to be the first known wave of technological change that we, humans, do not know how to exploit. Two obstacles seem obvious: energy supply and capital allocation in space. Digital technologies help us to save energy, but they are quite energy consuming in themselves. The capacity to generate much more electric power than we do today seems a prerequisite for a full exploitation of digital solutions. Changing the logic of production or the allocation of capital in space is another obvious challenge. Global manufacturing is mostly governed by the paradigm of factory, i.e. by thinking about the production of goods as an activity centralized in space and based on huge sums of capital. Digital technologies demand quite the opposite. They require quick, locally targeted reactions to new information. They act very much as nervous systems do: when a new type of molecules is needed in a given location in the body, those molecules are engendered locally or transported to that precise spot in a just-in-time manner. If our bodies worked as our factory-based economy works, our entire arms would be covered with scar tissue every time we have our finger cut! A paradox appears: flexibility, and therefore fast circulation of capital, seems to be the key factor in reaping economic benefits from digital solutions; at the same time, hoarding of capital clearly prevails over the willingness to make it circulate. Digital technologies push us to exchange more intensely, yet we do not want to do it. There is a screw wedged between the cogwheels, or some cogwheels do not connect.

John Maynard Keynes (Keynes 2007 [1935]), in Chapter 24 of his treatise on employment, interest and money, raised some claims that strangely fit the present situation in the global economy. First of all, Keynes argued that, at any given point in time, the demand for capital is strictly limited: it is possible to accumulate enough capital to a point where the marginal efficiency of any new investment in productive assets tends towards zero. In such a state of things, the actual return on investment would barely cover the depreciation of capital goods and the occasional losses connected with the so-called operational risk in business. Keynes argued that, in such an economic environment, the typical capitalistic behaviour is precisely the tendency to hoard capital or, in his own words, "the rentier aspect of capitalism". That rentier capitalism was, according to Keynes,

the main cause to blame for the Great Depression of the 1930s. Presently, we are witnessing a globally quickening cycle of obsolescence in fixed assets and, at the same time, an increased propensity to hoard value through the accumulation of fixed assets. Interestingly, Keynes perceived such a type of capitalism as a transitory phase, natural in the presence of reduced rates of return on investment and ready to diffuse in new activity should a new wave of technological change appear. Up to this point, the diagnoses by Schumpeter and Keynes are very similar, yet they differ as to what to do next. Schumpeter argued that scientific progress, essentially exogenous to economic cycles, can be the only real change. In other words, the Schumpeterian way out of the Schumpeterian depression consists in waiting patiently until a new wave of innovation starts spreading across the social system. On the other hand, Schumpeter did not advocate financial governance (fiscal or monetary) on the part of governments as an accelerator of change. On the contrary, he perceived all the types of "stimulation policies" through specific fiscal stances or monetary institutions as essentially inefficient in the sense that they distort entrepreneurial judgment as regards opportunities to innovate and just prolong the phase of depression, possibly decorating it with some short-lived revivals. John Maynard Keynes adopted a different view: it is both possible and salutary, in the presence of the prevailing rentier-type attitudes, to increase the volume of capital until it ceases to be scarce. The idea was that the basic rate of return on passive, purely financial investment should not be sufficient to pay the direct income tax on such purely financial income. Taxation can be so arranged that only productive investment in the really working assets leaves the investor with comfortable after-tax net profit. Keynes insisted that he could not provide any ready-made scheme of such a tax policy. In his own words, *only experience can show how far the common will, embodied in the policy of the State, ought to be directed to increasing and supplementing the inducement to invest*. Thus, we come to the State. In many situations, when we feel disoriented in our social environment, we tend to claim that "the government should do something about it". As a species, we are facing dire natural challenges and, as a social order, we seem to be going through a being-at-a-loss phase of economic activity. What can governments possibly do about it?

It is possible to assume that operational business claims (i.e. receivables and accounts payable) largely cancel themselves mutually out on the global scale, at least until we start trading with some alien civilizations. Thus, the money we have can be roughly equated with the amount

of the circulating capital. The Penn Tables 8.1 database (Feenstra et al. 2015) supplies information about the available stock of fixed amortizable assets (capital stock), and the publicly available database of the World Bank shows the supply of broad money (cash in circulation plus balances on current accounts plus term deposits and securities possible to equate to monetary deposits). Both are expressed in constant 2005 US dollars, yet with a hint of methodological doubt. The stock of fixed capital outside the United States is converted into US dollars at the constant Purchasing Power Parity from 2005. The World Bank data about money supply is converted into US dollars according to current Purchasing Power Parity from a given year. Thus, annual changes in the capital stock are basically insensitive to local inflationary trends, whilst the information about money supply takes account of it. Yet, roughly sketched as it is, the sum of broad money plus fixed assets allows to guess the total value of capital accumulated in the global economy. Having calculated that, it is possible to make one step further and incorporate information about global debt in the balance sheet. World Bank publishes data about the aggregate amount of credit granted by the banking sector to non-financial entities. Once again, the calculation is quite sketchy, as financial lending is not all of bank lending: substantial amounts of money are lent between non-financial entities (e.g. intra-corporate lending in multinational firms). Still, once again, as approximate as it is, the global amount of lending from banks outside the financial sector changes over time, and those changes give an idea of the proportions between debt and equity in the global economy. Figure 18 presents the author's calculation of that ratio between 1960 and 2011. Two trends are visible: in the period from 1960 until 1999–2000, the ratio increased. Then, after 2000, the trend reversed and global assets are now less and less financed with debt. Generally speaking, when the whole 1960–2011 period is considered, the equity in global assets was increasingly overwhelmed by debt.

The observable tendency for an enhanced role of debt as the method of financing global assets deserves some attention. The first and most obvious association is that with the financial condition of the banking system. More credit from banks means more capital in the banks. In the balance sheet of a bank, loans granted to customers are assets with various degrees of risk and liquidity. More assets on the active side of the balance sheet require more capital on the passive side. As the World Bank data technically report bank credit to the non-financial sector, relative changes in the supply of that should be basically net of relative changes

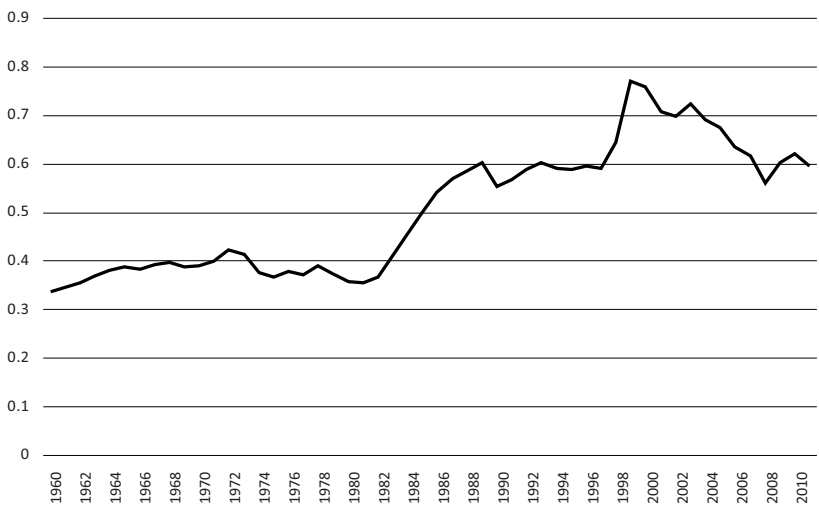

Figure 18. Debt to equity ratio in the global assets
Source: author's own elaboration based on the data available at www.worldbank.org and in Penn Tables 8.1.

in interbank lending. Thus, more credit granted and present on the active side of the balance sheet must be fuelled by more equity invested in banks on the passive side. In order to make the point of that logic, basic numbers can be useful. According to Penn Tables 8.1, the global stock of fixed amortizable assets grew by 1027% between 1960 and 2011. The supply of broad money increased by 22.7% over the same period, whilst the supply of credit from the banking sector, and thus the equity of that sector, grew by 1786.6%. For each million of US dollars materialized in fixed assets, more than 1.7 million has been invested in the banking sector.

3.5. National case studies

A cursory overview of the main trends observable in the global economy suggests passing from the level of global generality to studying some more focused cases. In this chapter, an exploratory path of research is developed, delving into national case studies and studying local particularities. It is interesting to explore individual country cases projected against the background of global tendencies.

Five countries have been chosen as case studies: United States, Bolivia, New Zealand, Mexico and Israel. The logic underlying the choice of these particular countries was quite intuitive. The United States is the biggest economy in the world and whatever happens there is likely to have a major impact on other countries. In terms of the political system, the United States is supposed to be the cradle of modern democracy, a kind of "patient zero" in the diffusion of institutions commonly associated with the constitutional state. The other four countries were intuitively picked as individual stories of achievement in both political reforms and economic development. Bolivia and Mexico are cases of strong social tensions, due to significant ethnical disparity combined with noticeable inequalities in income. New Zealand is interesting mostly because of its fiscal system, based on such unique institutions as accrual-based budgeting or the imprest budget, which provide the legislative branch in the government with unique flexibility in its relations with the executive. Finally, Israel is a case of economic success and a relative political stability in an apparently adverse international context. Being essentially a large piece of desert, located between unfriendly and politically unstable neighbours, having experienced a dire fiscal crisis in 1999–2002, Israel maintains an acceptably equitable democracy and has achieved an impressive technological progress. Each case is studied along the lines presented earlier on the global scale. Velocity of money, its connection with the financial markets, accumulation of fixed assets and energy consumption are used to study the "capitalistic" aspect of each country under scrutiny. Country-specific information provided by the previously cited Database of Political Institutions makes up the core of political analysis, whilst the fiscal variables collected by the author in the previously cited sample of 77 countries attempt to connect capitalism with the political systems in each national case.

There are four countries, namely the BRICs (i.e. Brazil, Russia, India and China), which strike by their absence from the national case studies presented further. Without them, the casual review is far from being fully representative. Unfortunately, the governments of those countries do not provide internationally recognized statistics of net public indebtedness. In their case, it is impossible to calculate the value of liquid financial assets held by the public sector, which is considered by the author as a key variable, connecting capitalistic accumulation with political processes. With those big absences, the case studies presented further exemplify the patterns of the intersection between capitalism and political power.

3.5.1. United States

The biggest economy in the world, the United States of America, is a presidential political system with a plural electoral regime. For the most part of the observation span regarding political institutions, namely the years 2001 to 2010, the United States displayed null political polarization and moved to the "high" bracket in this respect post 2011. From the capitalistic point of view, the US landscape is pretty serene. In comparison with the global trend, the US economy displays a relatively steady velocity of money, noticeably greater than the global average. In terms of energy use per capita, the United States is one of the most energy-intensive economies in the world, although the otherwise puzzling correlation between the velocity of money and the energy use per capita, clearly observable on the global scale, is not really obvious in the US. The average stock of fixed capital per capita, calculated on the basis of data available in Penn Tables 8.1, is still almost three times the global average, yet that capital intensity is not as significantly above the rest of the world as it used to be in the 1960s to the 1980s. What we have here is good, solid, stable capitalism, slightly giving ground to other national capitalisms. Both the propensity to save and to invest is on decline. In 2001, the US rate of gross national savings, as reported by the International Monetary Fund, was 19.4% of the GDP, and presently it oscillates around 16%, consistently some 3% of the GDP below the rate of investment.

Table 11 offers a glimpse of the fiscal stance observable in the US economy. The fiscal stance of the United States" government is a deepening, negative structural balance and a quickly growing indebtedness. In the long run, the amount of liquid financial assets held by the government (i.e. the residual difference between the gross public debt and the net one) has increased in relation to the GDP, and has remained relatively stable in relation to the stock of fixed capital in the economy. Yet, growth in relation to GDP was quite moderate.

There are two interesting facts about the fiscal stance of the United States. Firstly, the amount of the public sector's liquid financial assets in relation to the GDP is very close to the arithmetical average in the author's sample of 77 countries. In other words, this particular, capitalistic feature of the political system in the United States seems to be some kind of benchmark for the remaining 76 countries in the sample. Still, and this is the second interesting fact, the structural fiscal balance in the United States stays much below the sample's average (of course, "below" from

Table 11. Fiscal stance of the United States

Year	Structural balance, % of potential GDP	Gross public debt, % GDP	Net public debt, % GDP	Public sector's financial assets (gross minus net debt) % of GDP	Gross public expenditures, % of GDP
2001	-1.7	53.0	33.8	19.2	33.8
2002	-3.9	55.4	36.3	19.0	34.8
2003	-4.9	58.5	39.7	18.8	35.4
2004	-5.0	65.5	46.9	18.6	35.1
2005	-4.2	64.9	46.3	18.6	35.2
2006	-3.5	63.6	44.8	18.9	35.0
2007	-4.3	64.0	44.5	19.5	35.7
2008	-6.2	72.8	50.4	22.4	38.0
2009	-7.9	86.1	62.1	23.9	43.1
2010	-9.7	94.8	69.7	25.1	41.3
2011	-8.3	99.0	76.2	22.8	40.1
2012	-6.8	102.4	80.1	22.2	38.7

Source: International Monetary Fund.

the perspective of negative values). The structural fiscal balance can be perceived as that part of the potential GDP which a given economy trades off against a stream of the financial capital absorbed through the legal mechanism of public borrowing. The biggest economy in the world clearly uses this capital leverage on an increasing scale, as the global flows of capital invested in fixed amortizable assets drift more and more towards the emerging markets. As the US economy is absorbing capital through public debt, it is giving capital away through a consistently negative current account balance (Table 12). An interesting picture appears: the public sector is gently swelling, in capital terms, at the expense of the private sector, and still the whole process is so gradual that it preserves the essential economic and political stability of the country. That swelling seems to be connected to economic shocks: the increase in the relative value of the government's liquid financial assets is particularly pronounced in the times of economic disturbances. A speculative interpretation, at the frontier of politics

Table 12. Savings, investment and current account balance in the US economy

Year	Private investment % of GDP	Gross national savings % of GDP	Current account balance % of GDP
2001	22.0	19.4	-3.7
2002	21.6	18.1	-4.2
2003	21.7	17.3	-4.5
2004	22.5	17.5	-5.1
2005	23.2	17.8	-5.6
2006	23.3	19.1	-5.8
2007	22.3	17.3	-4.9
2008	20.8	15.5	-4.6
2009	17.5	14.4	-2.6
2010	18.4	15.1	-3.0
2011	18.4	15.8	-2.9
2012	19.0	16.3	-2.7

Source: International Monetary Fund.

and economics, can be developed. As the author's previously presented findings show (see Chapter II), the absorption of capital in the public sector is closely related to the number of distinct veto players in the political system. It is possible to assume that each economic shock, in a society very fond of being wealthy, creates an additional social tension which, in turn, is neutralized by the emergence of new political players in the body politic. For want of a better word, those new players can be called "local leaders". They are supposed to articulate the views of particular social groups who feel harmed by economic adversities. In order to have any actual political influence, the local leaders need economic power through the appropriation of capital, and thus they contribute to the gain in weight of the public sector in general.

3.5.2. Bolivia

Regarding the constitutional order, Bolivia is a presidential system with plural elections and a political polarization progressively decreasing

from high (around 2000) through moderate to low. This is an example of deep political reforms, which helped to bridge just as deep social divide (Van Cott 2000; Arnold 2004; Laserna 2009). Still, some authors claim that even those deep reforms did not completely defuse social tensions (O'Donnell et al. 2004). The country went through a deep political change, with president Evo Morales taking office in 2006. Since then, some authors have called Bolivia "the first post-neoliberal democracy in the world" or a "new socialism" (Kohl, 2010). In 2009, the constitution of the country was changed, with an important reform of land property and land management, inclusive of a new policy regarding hydrocarbons (Postero, 2010). As for the political system, the new constitution claimed to implement a new form of democracy, strongly participatory and communitarian (Schilling-Vacaflor 2010). Here comes the first interesting contradiction. The Database of Political Institutions indicates that in the years 2000–2002 Bolivia displayed a high political polarization (POLARIZ = 2), to pass into the zone of moderate polarization (POLARIZ = 1) from 2003 to 2005, and from 2006 onwards ended up in cluster #1, with no observable polarization. Thus, some authors claim that the number of partisan veto players has increased since 2006, whilst other authors suggest just the contrary.

As for the current fiscal flows (see Table 11), public expenditures increased their share in the GDP over the period studied.[8] Unfortunately, there are no available data about the structural balance, and the net lending on the part of general government is used in this case as the main measure of the current fiscal balance, which passed from a dangerously deep deficit between 2000 and 2005 to a significant, yet wobbly surplus from 2006 onwards. The transition from a deeply negative current fiscal balance to a clearly positive one is almost intriguing. Fiscal reforms usually take more than one year to produce their full outcomes.

Both gross and net public debt rapidly increased between 2000 and 2005, to start falling sharply afterwards. Intriguingly, the amount of financial assets held by the public sector grew over the whole period studied, and post 2006 that growth was truly spectacular. As a matter of fact, this particular fiscal variable follows the clearest trend among all the descriptors of fiscal stance adopted in this study. In that respect, Bolivia seems to be the opposite of the United States: the pumping up of liquid financial assets held by the public sector is accompanied by the transition

[8] A separate table in the Appendix presents the quantitative data for Bolivia.

Table 13. The fiscal stance of Bolivia

Year	General government net lending, % of GDP	Gross public debt, % GDP	Net public debt, % GDP	Public sector's financial assets (gross minus net debt) % of GDP	Gross public expenditures, % of GDP
2000	-3.7	66.9	58.9	8.0	29.3
2001	-6.8	60.0	51.7	8.2	32.0
2002	-8.8	69.1	62.1	7.0	33.3
2003	-7.9	74.1	66.4	7.6	32.0
2004	-5.5	89.6	81.0	8.6	32.3
2005	-2.2	80.4	71.1	9.3	33.2
2006	4.5	55.2	41.9	13.3	29.8
2007	1.7	40.5	27.3	13.2	32.7
2008	3.6	37.2	20.6	16.5	35.3
2009	0.0	40.0	23.1	16.8	35.8
2010	1.7	38.5	18.4	20.1	31.5
2011	0.8	34.7	14.4	20.2	35.4
2012	1.8	33.4	11.1	22.4	36.1

Source: the sample of 77 countries.

from trading off some part of the GDP against current fiscal solvency to actually giving away some of that solvency.

The peculiar fiscal change in Bolivia becomes even more interesting when sketched against the background of private capital flows: private investment, gross national savings and the current account balance, as shown in Table 12. Political reforms were preceded by a sharp decline in private investment, which was reversed just before the reforms had truly started. An interesting supposition appears: the political reforms in Bolivia could have been triggered, to some extent, by a shift of confidence on the part of private investors, from the old political establishment to a new one. Interestingly, the political reforms were accompanied by a continuous rising trend of private savings, whose share in the GDP more than doubled in 12 years. The current account balance of the country partly solves the mystery of a sudden improvement in the current

Table 14. Saving, investment and current account balance in Bolivia

Year	Private investment % of GDP	Gross national savings % of GDP	Current account balance % of GDP
2000	18.1	11.0	-5.3
2001	14.3	11.3	-3.4
2002	16.3	12.3	-4.4
2003	13.2	14.6	1.0
2004	11.0	17.0	3.7
2005	14.3	19.9	5.9
2006	13.9	26.6	11.2
2007	15.2	28.6	11.4
2008	17.6	29.0	11.9
2009	17.0	22.9	4.3
2010	17.0	25.0	3.9
2011	19.6	25.3	0.3
2012	17.7	25.7	7.8

Source: International Monetary Fund.

fiscal stance of the government: the public sector could afford to give away some of its capital liquidity as the country absorbed additional capital through trade.

The medium-term fiscal and macroeconomic trends in Bolivia, observable on the grounds of the data published by the International Monetary Fund, can be put in the context of long-term trends regarding the velocity of money, energy use and capital stock per capita. Bolivia has been chronically undersupplied with both financial and physical capital, and these two capitalistic issues have been addressed differently. As reported by the World Bank, back in the 1960s the Bolivian economy displayed such a low supply of broad money that its velocity reached a crazy sevenfold multiple of the global average. Since then, the supply of money has been growing very fast, accompanied by a corresponding, spectacular fall in velocity, which, presently, is some 60% above the global average. In terms of physical capital, the situation looks different. The data

provided by Penn Tables 8.1 regarding the stock of fixed amortizable assets per capita indicate a sharp increase in real terms over the past decades, and yet this increase has been much more modest than the global average. Between 1950 and 2011, the global capital stock per capita grew more than five times in real terms – in Bolivia it was just 2.4 times. In 1960, the capital stock per capita in Bolivia was some 47% of the global average, and it is just 19% now. Bolivia is also one of the least energy-intensive countries in the world, with some 35% of the global average, which is still an increase as compared to the 1970s, when the average Bolivian consumed only some 17% of the global average in energy.

As an individual case, Bolivia is like a huge, nation-scale absorptive state for capital. Capital is accumulated both in the private and in the public sector. The case of Bolivia makes a sharp contrast in comparison with the United States. The latter is a politico-economic system, where the abundance of capital stabilizes both the economy and the world of politics. The former is an environment, which just pushes various social groups to acquire more capital goods. That push seems to act like some sort of a political self-regulating mechanism: only politicians able to satisfy that craving for capital can stay in office for longer than one term.

3.5.3. New Zealand

Capital flows away from strong executives toward countries where the constitutional order effectively puts a limit to the powers invested in the executive branch. The example of China, cited earlier after Barry Weingast, directs our attention to federalist institutions. Yet, another country in the Pacific region represents a different and interesting pattern of changes in the political system: New Zealand. This country has become a kind of a mythical beast as regards fiscal policy: with a consistently negative current account balance, it managed to generate a consistently positive structural fiscal balance. That is probably an even greater performance than the fiscal stances of the Scandinavian countries. The latter, although displaying very efficient fiscal policies, find the financial leverage in industrial expansion and in the exports of natural resources.

New Zealand is a parliamentary political system, with a prevailing plurality in the electoral regime and a changing degree of political polarization as regards the key aspects of economic policy. Over the period of the observation, New Zealand went through a deep change in public governance, and a substantial part of that change specifically concerned the fiscal

policy. It is commonly assumed, that the entry into force of the Public Finance Act 1989 seems to have been a milestone in the process, introducing a novelty at the global scale, namely passing from cash-based budgetary management to accrual-based one (see for example: Goldman, Brashares 1991: 77–85). In New Zealand, the purpose of the systemic change was to consistently minimize the budgetary slack. As the DPI data shows, as those public reforms were implemented from 1985 to 1994, no political polarization concerning the economic policy was observable (POLARIZ = 0). From 1995 onwards, polarization jumped to "high" (POLARIZ = 2), and remained so for the rest of the period observed, until 2012.

At the beginning of the public reforms, the public sector was quite greedy, holding over 24% of the GDP in liquid financial assets and recording a significant gross and net debt (see Table 13). Between 1985 (when our span of observation began) and 1989 (when the Public Finance Act 1989 was voted), the share of public, financial assets in the GDP shrank significantly and the structural balance improved. It was probably the most immediate result of the transition from cash-based budgetary accounting to accrual based one. That shift probably terminated a lot of small capital pockets held by public agents through the postponement of cash settlements. The spectacular deflation of public financial assets and the betterment of the structural balance are the most striking fiscal changes accompanying the reforms. Later on, over the next 15 years, public debt decreased significantly both in gross and net terms. Public financial assets inflated again after 2004, just as the public debt, not to the previous levels, though. Interestingly enough, private capital aggregates, namely saving and investment, changed in close correlation with the public ones. In general, 2003–2004 seemed to be the moment when the fiscal reforms reached a peak in their quantitative outcomes. Afterwards, the fiscal stance started to reverse.

In the 1980s, the political system reached some kind of general agreement about the economic policy to follow, which was reflected in the absence of political polarization and in bold constitutional reforms. The state of partisan unanimity lasted until 1994, when significant disparities in the economic programmes appeared. The striking fact is that the beginning of significant political polarization coincided almost perfectly with the first official publication of the government's balance sheet (Dale, Ball 1996).

One of the principal, officially disclosed goals of the fiscal reform in New Zealand was the reduction and possible eradication of

the so-called budgetary slack, defined as deliberate, financial underperformance on the part of public agents, in order to obtain or to retain more capital than they actually need to carry out the mission assigned (see for example: Jensen 2003: 30–56). Budgetary slack was supposed to be minimized by changing the overall system of accounting in the public sector, from the cash-based to the accrual-based one. The pattern of change seems to have had worked: four years after the implementation of the reforms, the structural fiscal balance turned to positive and remained such for the next 14 years, until the beginnings of global crisis in 2008.

Leaving aside the clichés about "lazy clerks", budgetary slack is obviously a by-product of some strategies on the part of public agents, with some positive outcomes in view. Looking at budgetary slack only as a maladaptation to the economic environment means assuming that people who are smart enough and tough enough to make their way in politics suddenly turn dumb when it comes to managing public finances. In other words, what is seen as maladaptation from one point of view must be a positive adaptation from another point of view. There are some political strategies that find their expression both in the phenomenon of budgetary slack and in its actual fiscal outcomes. The case of New Zealand suggests that we are talking about strategies which bring different fiscal outcomes depending on the system of budgetary accounting in force.

Two basic models of budgetary accounting are possible: the cash-based on the one hand, and the accrual-based one on the other. The cash-based model largely prevails in the world and allows public agents to record officially their fiscal flows when, and only when, cash is spent or received, respectively, on or for public expenditures and public revenues. Conversely, the accrual-based model compels public agents to record fiscal flows when the corresponding liabilities or claims emerge. The cash-based system, still applied in the fiscal practice of most countries, allows public agents to keep some bills unpaid until the creditors take legal action, to create an illusion of good fiscal performance in the meantime and pump up gross public indebtedness. Similarly, the system allows for leaving some tax claims without actual enforcement, thus creating a discreetly governed system of unofficial tax crediting for the chosen ones. In order to understand the fiscal implications of going cash-based or accrual-based in budgetary accounting, it should be kept in mind that fiscal policy consists in managing both current flows and capital balances. Fiscal policy may be considered as public management of capital balances, with the big – and so far unanswered – question about the equilibrium point.

Table 15. The fiscal stance of New Zealand

Year	Structural fiscal balance, % of GDP	Gross public debt, % GDP	Net public debt, % GDP	Public sector's financial assets (gross minus net debt) % of GDP	Gross public expenditures, % of GDP
1985	-5.0	67.1	43.0	24.1	41.9
1986	-4.0	71.6	46.9	24.7	42.5
1987	-2.8	65.8	44.9	21.0	41.8
1988	-1.2	57.2	44.0	13.3	41.8
1989	-0.8	57.7	49.1	8.6	43.5
1990	-0.7	58.2	50.1	8.0	45.1
1991	-2.4	60.8	53.0	7.8	48.1
1992	-2.0	61.5	53.9	7.7	47.8
1993	0.7	57.3	48.3	8.9	42.6
1994	2.0	51.4	44.1	7.3	39.0
1995	2.7	45.6	38.6	7.0	37.8
1996	1.8	39.1	32.2	6.8	36.3
1997	1.4	36.3	29.5	6.8	35.7
1998	0.8	36.2	26.9	9.3	36.6
1999	-0.1	33.6	23.5	10.0	35.7
2000	0.4	31.6	21.7	9.8	34.9
2001	1.2	29.6	20.1	9.4	33.9
2002	1.8	27.7	18.9	8.8	33.5
2003	2.1	25.9	17.3	8.6	33.3
2004	2.6	23.6	14.4	9.2	32.8
2005	3.1	21.8	11.3	10.5	33.7
2006	2.4	19.3	8.8	10.5	34.4
2007	2.6	17.2	6.5	10.7	33.9
2008	1.2	20.1	7.4	12.8	35.4
2009	-1.0	25.7	11.6	14.1	37.1
2010	-4.0	31.9	16.9	15.0	40.0
2011	-3.7	37.0	22.1	14.9	39.7
2012	-0.9	37.5	25.3	12.2	36.4

Source: International Monetary Fund.

The answer might be a set of ratios calculated on the basis of the government's balance sheet. In that respect, New Zealand's example is somehow enlightening. In the mid-1990s, the government of New Zealand started to publish a comprehensive balance sheet of the public sector, thus putting in practice all the above-mentioned considerations about fiscal flows being a form of capital entrusted with public agents (see for example: Dale and Ball 1996). That balance sheet contained a comprehensive valuation of the public assets, inclusive of state-owned enterprises, and the physical assets of the state. On the passive side, the balance sheet introduced three interesting points. Firstly, it included currency issued as a liability, supposedly contributing to the financing of assets. Technically, the value of the currency issued is a liability of the central bank and is accounted for as a monetary aggregate rather than a fiscal one. Thus, the example of New Zealand shows that the capital approach to fiscal policy might contribute to bridging the gap between monetary and fiscal policy. Secondly, the balance sheet showed that at the very beginning of the reforms, current payables and provisions, as compared to gross public debt, corresponded to 10% of the latter. On the active side of the balance sheet, the current receivables were almost exactly equal to the current payables. Hence, the balance sheet clearly showed the existence of circulating capital temporarily retained in the public sector. Thirdly, that balance sheet went up to calculate the net worth of the public sector in the same way as the equity of a firm would be estimated, namely as the residual value of assets after the deduction of liabilities.

From the purely capitalistic point of view, New Zealand is an interesting case of giving off capital to the rest of the world. In terms of capital stock per capita, as reported in Penn Tables 8.1, New Zealand achieved an accumulation of almost 300% between 1950 and 2011, with the global economy striking 500%. Currently, New Zealand is some 33% above the global average in terms of thus measured capital intensity: in 1950, it was 125% above the global average. Table 14 introduces some information about savings, investment and current account balance in New Zealand's economy. The current account has been consistently negative, and the rates of accumulation in private capital, namely savings and investment, have slowly decreased in the long run. The tendency to produce a clearly positive structural fiscal balance suggests that the economy of New Zealand tends to trade off its capacity to absorb capital through public borrowing against for the possibility to exploit fully its own productive capacities. An interesting metaphor can be formed, as New

Table 16. Savings, investment and current account balance in New Zealand

Year	Private investment % of GDP	Gross national savings % of GDP	Current account balance % of GDP
1985	26.6	19.3	-7.3
1986	24.1	19.3	-6.4
1987	22.4	18.6	-4.8
1988	20.0	18.4	-0.9
1989	22.0	18.2	-3.7
1990	20.5	16.9	-3.5
1991	16.2	14.4	-3.0
1992	17.6	14.5	-4.4
1993	20.0	17.0	-4.1
1994	21.5	18.8	-4.0
1995	22.5	19.7	-5.0
1996	22.7	18.3	-5.8
1997	21.7	16.8	-6.2
1998	20.1	15.8	-3.6
1999	21.2	15.2	-6.1
2000	21.8	16.7	-4.6
2001	20.9	19.6	-2.3
2002	22.4	20.0	-3.6
2003	22.5	20.8	-2.5
2004	24.2	19.4	-4.6
2005	24.5	17.1	-7.2
2006	23.0	15.9	-7.2
2007	23.9	16.5	-6.9
2008	22.7	15.3	-7.8
2009	19.0	16.7	-2.3
2010	19.2	17.0	-2.3
2011	18.9	16.0	-2.9
2012	20.2	16.1	-4.1

Source: International Monetary Fund.

Zealand is compared to the previously studied two cases of the United States and Bolivia. The United States is a steady giant, Bolivia is a greedy challenger in the global market for capital, whilst New Zealand appears as a lean, ascetic monk pursuing a path of self-development. In this context, it is worth having a glance at the velocity of money in New Zealand. As the reader might remember, the general global trend is that of progressively decreasing velocity of money since 1950. In New Zealand, it was different: between 1950 and 1970, the economy seemed to be extremely in need of money and its velocity almost doubled over 20 years. Then, between 1971 and 1990, the velocity of money literally slumped. Starting from 1990, it closely pursued the steady decline observable in the global economy. In the spirit of this book, the velocity of money is considered mostly as an indicator of efficiency in the banking sector. The New Zealand's case is a quick surge in such efficiency, followed by a quick slump, which, in turn, was followed by radical attempts to make the public management of capital more efficient.

3.5.4. Mexico

Mexico, geographically situated between Bolivia and the United States, is an interesting case of oscillatory changes with respect to the investigated variables. This is a presidential system with a plural electoral regime. Political polarization regarding the main issues of economic policy remained low or moderate during most of the analyzed period, namely from 1998 until 2012. Some oscillation can be noticed: between 2001 and 2009, political polarization moved from non-existent (POLARIZ = 0) through moderate to high, just to return to moderate from 2010 onwards. That political oscillation was accompanied, roughly in step, by a wavy change in capital fiscal variables (gross debt, net debt, financial assets) and in the structural balance. An unequivocally growing share of current fiscal flows in the GDP could be observed, so as the worsening ratios of savings and investment. Interestingly, the social situation seemed to have had improved, as seen through the double lens of the primary completion rate and the rate of vulnerable employment. In general, the growing political polarization was accompanied by a shrinking indebtedness, both in gross and net terms, and by a growing amount of financial assets held by the government. The growing political polarization in this case went together with the building-up of borrowing capacity by the public sector.

Table 17. The fiscal stance of Mexico

Year	Structural fiscal balance, % of GDP	Gross public debt, % GDP	Net public debt, % GDP	Public sector's financial assets (gross minus net debt) % of GDP	Gross public expenditures, % of GDP
1998	-5.4	44.1	37.7	6.4	22.4
1999	-5.9	46.3	38.8	7.5	22.4
2000	-4.0	41.9	35.4	6.4	20.9
2001	-3.2	41.1	35.6	5.5	21.2
2002	-3.5	43.5	38.1	5.4	22.1
2003	-2.6	44.7	35.6	9.2	22.5
2004	-2.1	40.9	32.8	8.0	20.3
2005	-2.4	39.0	31.5	7.5	21.7
2006	-2.5	37.8	29.8	8.0	22.6
2007	-2.5	37.6	29.1	8.5	22.8
2008	-2.5	42.9	33.2	9.7	25.6
2009	-4.8	43.9	36.3	7.7	27.2
2010	-4.5	42.2	36.2	6.0	26.7
2011	-4.2	43.3	37.5	5.7	26.3
2012	-4.5	43.3	37.8	5.5	27.2

Source: International Monetary Fund.

In the long run, the fiscal stance of the Mexican government is a sort of standstill at a very low level of economic power. Moderately indebted, the Mexican government is among the least capital-endowed governments in the world when appraised in terms of the financial assets held. A striking observation can be made: whilst being economically and politically different from the United States in almost every conceivable aspect, the Mexican government is as steady in its fiscal stance as the US. Everything else remains different on the two sides of the national border except this tendency to standstill, which seems just to spill over from the giant economy of the United States to the much weaker one of Mexico. One

Table 18. Savings, investment and current account balance in Mexico

Year	Private investment % of GDP	Gross national savings % of GDP	Current account balance % of GDP
1998	26.8	23.2	-3.2
1999	25.7	22.4	-2.4
2000	26.0	22.4	-2.7
2001	23.4	19.9	-2.4
2002	22.6	20.5	-1.9
2003	21.9	20.7	-1.2
2004	22.7	21.8	-0.9
2005	22.3	21.3	-1.0
2006	23.5	22.7	-0.8
2007	23.4	22.0	-1.4
2008	24.4	22.6	-1.8
2009	22.9	22.0	-0.9
2010	22.0	21.7	-0.3
2011	22.3	21.2	-1.1
2012	23.2	22.0	-1.2

Source: International Monetary Fund.

could almost think about it in terms of thermodynamics, as if a much larger body steadied the processes occurring on a smaller one.

The capitalistic landscape in Mexico is that of slow decapitalization. Between 1950 and 1985, Mexico almost perfectly followed the global average in terms of capital stock per capita. From 1986 until 1997, a gentle decline of a few percentage points below that global average was noticeable. From 1998 onwards, the capacity to accumulate fixed capital stock suddenly slumped 20% below the global average and is currently ca. 30% below. Both the rates of gross national savings and of private investment are generally stagnating, with a slight tendency to decline. The balance on the current account has been consistently negative for decades. In monetary terms, the Mexican economy displays a chronic tendency

Table 19. The fiscal stance of Israel

Year	Structural fiscal balance, % of GDP	Gross public debt, % GDP	Net public debt, % GDP	Public sector's financial assets (gross minus net debt) % of GDP	Gross public expenditures, % of GDP
2000	-6.4	75.0	68.0	7.0	49.2
2001	-7.0	79.0	72.8	6.2	51.5
2002	-6.5	86.5	80.1	6.4	52.9
2003	-5.6	90.0	82.9	7.1	51.6
2004	-4.4	89.7	82.9	6.8	48.7
2005	-3.6	87.0	79.6	7.4	47.4
2006	-1.8	79.8	71.8	8.0	45.7
2007	-1.7	72.9	65.8	7.1	44.0
2008	-3.7	69.2	64.1	5.1	43.2
2009	-5.7	69.5	66.2	3.3	43.1
2010	-4.9	66.5	64.1	2.4	42.2
2011	-4.4	65.3	63.2	2.1	41.9
2012	-5.4	62.8	62.6	0.2	41.0

Source: International Monetary Fund.

to champion high velocity of money, as compared to the global average. Whilst staying consistently above the said average, in some periods the Mexican currency noted real records in velocity. In 1988, for example, it reached more than eight times the global average.

3.5.5. Israel

Israel is a case of a parliamentary system accompanied by a proportional electoral regime and high political polarization regarding the main issues of economic policy. Israel shows some really original traits regarding the analyzed topic. The consistently negative structural fiscal balance suggests a recurrent trade off between the use of productive potential in the economy and the imperative to maintain financial liquidity on

Table 20. Savings, investment and current account balance in Israel

Year	Private investment % of GDP	Gross national savings % of GDP	Current account balance % of GDP
2000	21.6	20.0	-1.6
2001	20.9	19.3	-1.6
2002	19.4	18.3	-1.1
2003	18.5	19.1	0.5
2004	18.5	20.2	1.6
2005	19.5	22.4	3.0
2006	19.7	24.3	4.7
2007	20.5	23.6	3.2
2008	20.1	21.5	1.4
2009	17.6	21.5	3.8
2010	18.1	21.2	3.1
2011	20.2	21.4	1.3
2012	20.7	21.0	0.3

Source: International Monetary Fund.

the part of the government. Still, the amount of liquid financial assets held by the government of Israel is generally low, and recently it plunged close to null, which was accompanied by a significant reduction of public debt. The government of Israel seems to have stripped itself in financial terms, whilst transferring its liquidity to the private sector and reducing its current presence in the economy, as can be measured by the decreasing share of public expenditures in the GDP. An important institutional component in that process consisted in the development of a network of public, peripheral agencies focused on economic development (Getz, Goldberg 2015), thus finding positive employment for various partisan veto players. Israel seems to have developed some sort of capital transmission from current fiscal flows directly into privately held assets, without bulking financially the public sector.

Israel is a peculiar economy. As a capital market, the Israeli economy is very open to international transactions, mostly through the transnational

ownership of companies. In terms of money supply, its monetary system is quite close to the global average, yet in the past, between 1950 and 1995, it experienced sharp peaks and troughs of efficiency. Between 1975 and 2004, Israel accumulated capital significantly faster than did the global economy, but since 2005 the country seems to have lost that momentum. The consistently positive current account balance does bring additional capital to the domestic market, and yet the clearly visible decapitalization of the public sector has its effects upon the whole economy. Israel seems to be the opposite of the United States, according the lines of study developed in this chapter. Whilst the United States hosts a slowly swelling public sector, which gains in weight as economic shocks occur, the Israeli state seems to be on a diet. As some authors argue (see for example: Nitzan, Bichler 2002), Israel is a case of hyper-instability in social, political and economic terms. This is a society of a quick demographic growth and increasing demographic complexity, with substantial immigration. There is a body of evidence that the phenomenon of mass migration to Israel, from countries with inferior institutional development, has contributed to the formation of highly efficient economic and political institutions in Israel itself (Powell et al. 2017).

Concluding remarks

In the present political order of the global community, constitutional states seem to be the necessary middlemen between any form of globally concerted initiatives, e.g. in such fields as climate change or poverty, and the actual activities at the level of local communities. Constitutional states sign and ratify international agreements and participate in international organizations, and therefore are supposed to translate the globally formulated goals into changes in their respective territories. At this international level of politics, two types of changes can be observed, with some kind of mutual contradiction between them. On the one hand, initiatives like the Paris Framework Climate Agreement suggest that constitutional states should have an increased role in economic and technological changes and, last but not least, should be the prime movers of capital between the developed countries and the developing ones. On the other hand, a new generation of trade agreements is emerging, e.g. the recently signed Trans-Pacific Partnership (TPP), or the Transatlantic Trade and Investment Partnership (TTIP), still in negotiation. Those agreements share a common trait which distinguishes them sharply from older ones such as the General Agreement on Tariffs and Trade: they enter very deeply into matters that in fact belong to constitutional law. In those new agreements, one can find regulations that pertain to such vital components of national constitutions as: citizenship, definition of national territory, or competences of governments at various levels (i.e. central and local). Whilst older trade agreements focused on what states should or should not do, the presently developing regulations governing trade take into account what states and governments actually are. The matters regulated so far by domestic, national constitutions are increasingly regulated at the international level. This, in turn, means that the geographically dispersed trial-and-error game in the forming of constitutional states progressively turns into the implementation of unified

standards. One could say it is a good thing as those standards seem to be acceptably democratic. Yet, standardization usually puts an end to experimentation. Social structures are technologies, in the sense that they play a vital role in the efficiency that we, as a species, demonstrate in using limited resources. Social structures, just as commonly understood technologies, need experimentation if they are to progress. The currently observable trends in international law seem to over-standardize constitutional orders and impede their development. An interesting correlation with global demographic growth and global migrations appears at this point: the greatest geopolitical changes seem to happen when the global stock of migrants grows much faster than the global population, i.e. when people start moving noticeably faster over the planet. A complex relationship appears: the links between populations and territories seem to be correlated with links between individual, national political systems.

Currently, the velocity of migrations, estimated as the residual difference between the rate of growth in the global migrant stock and the rate of growth in the global population, is growing. This phenomenon, in turn, is accompanied by the tightening margin of growth that the planet offers to the human population. We, as a species, seem to be reaching the limits of capacity in the exploitation of planetary resources. An influential stream of research, significantly represented in the works of the Club of Rome, claims that accumulation of fixed capital in the global economy is a key factor to achieve a salutary balance between the demographic expansion of humanity and the resources of the planet. Slowing down the accumulation of productive assets seems to be necessary in order to reach such a balance. Yet, accumulation of capital is very fast and seems to increase velocity, even when considered as a per capita ratio. Moreover, the velocity of money in the global economy has been consistently falling since the 1970s, just as the banking system seems to have bounced against the limits of its own efficiency in handling credit risk. Credit, as a financial leverage in capital accumulation, seems to have reached the peak of its relative importance around the year 2000, and has relatively stagnated since. In general, global capitalism is becoming a system of fast accumulation and slow circulation of capital.

This observation leads, once more, to look for insights about the role of constitutional states and their political systems in the accommodation of mankind to its tightening margin for growth. Those insights are quite interesting. Between 1975 and 2012, national political systems seem to have progressively gravitated from relatively dispersed patterns

of political power to more concentrated ones, both in constitutional and in partisan terms; presidential systems have become more widely present, to the detriment of parliamentary ones, and plural elections seem to push the proportional ones out of the stage. Yet, capital, measured by the available stock of fixed assets, goes against that current and tends to migrate towards systems with a relatively dispersed political power, i.e. parliamentary democracies with proportional elections. Capitalism says "no" to political trends, so to speak, and seems to move away from strong executives in the political systems. There is a long-term trend of reducing the relative amount of liquid financial assets held by national governments and of reducing the global net indebtedness, and yet the public borrowing seems to crowd out the private one. Overarching those trends, there is an even more interesting one: the global ratio of public expenditures, divided by the available capital stock, reached a peak in the mid-1970s, after more than 20 years of growth, and has been decreasing since. The curve looks as if constitutional states had gained economic importance first, up to a threshold reached in 1970s, and have been losing it since. The capitalistic aspect of constitutional states seems to be haunted by glaring contradictions, and those contradictions lead to a progressive loss of economic power in many of those states.

As the global geography of investment is considered, an interesting pattern appears: capital seems to accumulate in political systems with a relatively dispersed political power, and consistently avoids being accumulated in countries displaying a strong concentration of that power in the executive organs. Thus, an interesting path of research opens: maybe reduction of the executive can improve the capacity of constitutional states to face global civilizational challenges? In an even broader perspective, maybe we need more experimentation in our political systems? The current trends seem to indicate that countries across the world either converge toward a common constitutional pattern that we call democratic market economies or fall completely out of it, with no intermediate cases. Yet, what if we diversified a little bit? Experimentation leads to progress... In the context of those reflections, we can return once more to the issue that this book started with, namely to the new wave of international treaties being presently negotiated. This new generation of treaties significantly interferes into the subject matter commonly designated as constitutional law. One can even go as far as to say that those treaties are rewriting national constitutions. Two interpretations of that phenomenon are possible. On the one hand, it could be the supremacy of the few over

the many, namely the supremacy of American corporations over whole countries outside of the United States. Whilst this remains a plausible explanation, one could be tempted to assume that we, as the human race, are not entirely dumb. We are likely to have collective intelligence. If bees, ants and rats have it, why not us? The new generation of international treaties could be an expression of that collective intelligence doing some useful work. Treaties create natural limits to the freedom of the executive branch in the government. They tame overambitious local politicians. When they interfere deeply into the constitutional orders, as the present wave of trade facilitation does, they can contain the executive even better. Many social thinkers, both of the libertarian and the communal persuasion, would say that constitutional states are simply obsolete and cannot generate endogenously any useful change in themselves. Still, another possibility remains: constitutional states can create institutional change between them.

As collective intelligence of the mankind is in focus, one is tempted to think in evolutionary terms and imagine some enlightened path of progress that we can possibly find and follow, had not there been so much greed, fear and short-sighted selfishness. The author of the present book does not go that far. Having spent the early years of his life in the communist Poland, the author has a deeply ingrained conviction that anyone claiming to see an enlightened path of progress usually has quite mundane goals in mind. I think there is no path of light leading to a glorious future. Still, there is power, enormous power, in the consistent effort to figure out new ways of doing things. Perseverance in trying brings better results that one-time enlightenment.

Constitutional states seem to be the pivotal structure of economic governance in the global, institutional scheme. Yet, new forms of economic governance are emerging. They can be tentatively grouped into three categories: libertarian, collaborative and corporate. Libertarian initiatives seem to have gained power after the 2008–2009 financial crisis. It can be noticed that the libertarians have evolved. During the period between 1950 and 1980, their ideology focused on the private ownership of assets, especially real estate, as expressed for example by Heath (1957) or McCallum (1970). Presently, the libertarian doctrine seems to be grounded in the notion of social flexibility: modern libertarians assume that society is a form of technology. As such, it develops through diversity and experimentation. Flexible social structures based on private contracts are claimed to be much more suitable to achieve these ends that

the constitutional state (see for example: King 2005; Janeba 2006; Francis & Francis 2011).

On the other hand, collaborative structures are emerging in very close connection with technological innovation. This is the so-called "open source" culture, reflected, among others, in intellectual property based on the notion of creative commons (which is de facto collective property). This type of social structures takes the form of fluid, flexible networks, based on adherence through action rather than on formal contracts. Three-dimensional printing and software development are currently among the most preferred domains of those networks.

At the corporate level, interesting developments are taking place in the domain of international trade. The movement of trade facilitation finds a very explicit expression in the Trade Facilitation Agreement (TFA), negotiated in Bali in December 2013 under the auspices of the World Trade Organization. The TFA explicitly states that the principle of national sovereignty has produced too many non-tariff barriers to trade, and those barriers should be abolished in order to foster international trade. The World Trade Organization claims that especially the developing countries should give up some of the legal procedures they practise as regards imported goods in order to be able to have gains from trade. In parallel, regional agreements such as the Transatlantic Trade and Investment Partnership between the United States and the European Union, or the Trans-Pacific Trade Partnership between the United States and Asian countries, are being negotiated, in quite an intriguing secrecy. They all make up a new generation of international agreements and gradually introduce a new notion, namely the systematic primacy of corporate business interests over the interests of constitutional governments. That primacy seems to find its expression in the general principle that when national sovereignty gets in the way of international business, business should have priority.

Are we facing as deep a shift in the paradigm of public governance as these initiatives suggest, or are they just foam on the surface? If there is a paradigm shift, is it functional or dysfunctional regarding the ambitious goals of the Framework Convention on Climate Change? The present study attempts to tackle this issue, provides theoretical foundations for such an assessment and presents empirical evidence.

The big question is whether, and to what extent, social systems can improve endogenously. Social systems have the capacity to learn through interaction and experimentation, i.e. they have the capacity to generate

new, functional patterns of collective behaviour by experimenting with various strategies and sharing information about their outcomes. The accumulation of learning is imperfect.

Besides the possible control of territory, hierarchical social structures have the capacity to control capital goods through the acquisition of binding, enforceable claims on resources, or by force. Capital goods controlled exclusively by force have no measurable market value. The capacity of any social structure to impact or control the overall allocation of capital in the economic system depends on the share of the total capital stock that a given social structure can appropriate.

The current state of technology is reflected in the allocation of resources – capital and labour – between various technologies. Each individual technology is represented by a production function. The latter can display perfect substitution between capital and labour, in the Cobb-Douglas manner, or an imperfect one. Technological change means significant (i.e. more than random) change in the distribution of resources over the set of available technologies.

Systems of economic governance can be understood as complex sets of institutions pertaining to the appropriation and employment of valuable resources. Consistently with the relatively recent developments of the old institutional school, institutions emerge and change, as the outcome of linguistically logical statements about reality. Those linguistic structures give rise to recurrent forms of action, which transform into the rules of social games with imperfect information. Some of those rules are selected to be the constitutive rules of legal systems and become secondary rules of recognition as for the primary legal rules of conduct, in line with Herbert Hart's theory of law. **In other words, any institutionalized system of economic governance emerges and acquires relative stability as the outcome of past strategies applied by social agents. Any presently observable form of economic governance is behaviourally logical and, at the same time, lagging behind current events, to the extent that it is grounded in collective, past experience.**

The institutional structure of an economic system can be represented as a total of shares in the capital stock held by different types of social structures. The capacity, on the part of any type of social structures, to produce technological change depends on their relative share in the capital stock. In a simplified form, that institutional structure can be represented as a binomial distribution of capital between the constitutional states on the one hand and all the other types of social structures on

the other. Those other types of social structures primarily include: corporate structures, local communities and social networks of various types (e.g. collaborative commons as defined by Jeremy Rifkin). The current state of that binomial distribution, at a given point in time, represents the cumulative outcomes of collective learning until that moment.

It is further assumed that the capacity of constitutional states to appropriate capital depends both on the efficiency of employment that they use that capital for and on political legitimation granted to governments. Economic systems may be adjusting, in the long run, to the fact that governments tend to distort the marginal efficiency of capital when they appropriate it. As for the concept of legitimation, it can be understood in two, slightly different ways. On the one hand, legitimation is a set of rules in itself, and those rules emerge in a discursive process, according to the theory of discursive politics by Jürgen Habermas. On the other hand, at any given moment, the political system has some definite capacity to represent collective interests and assure the hold of the represented social groups on the capital stock available.

Significant institutional changes leading to the emergence of the presently known constitutional state took place on the rising tide of demographic revivals after major demographic slumps, associated with big waves of technological change. The demographic component has a significant impact upon institutional change and technological progress. Demographic growth means that each consecutive generation comprises more people than the previous one. New social roles can emerge as more people inhabit the same territory and use the same resources, and the system of social norms, legal rules included, becomes more and more complex. The faster the demographic growth, the faster the required complexity of institutions increases. As demographic growth slows down, the pressure on institutional complexity decreases. Social systems might find themselves with something, which, for want of a better expression can be designated as an "overhang of institutional complexity": institutions adapted to handle the quick emergence of new social roles become excessively complex regarding the current pace of social change.

On the other hand, demographic growth corresponds to the quantitative expansion of product markets and of the labour market. Following the classical Smithsonian assumption, it can be presumed that in the presence of a relatively fast demographic growth, domestic markets of individual constitutional states expand relatively fast, too. Conversely, when demographic growth slows down, or reverts to demographic depression,

domestic markets shrink, too. Technological innovation needs absorption in the form of new products and new businesses, if innovation is supposed to change the economic system. That absorption is relatively easier in the presence of a fast demographic growth. As population grows at a slower pace, or depresses, expansion of individual businesses is still possible, but it requires more effort in international trade. Thus, a relatively slow demographic growth creates pressure to increase international trade in order to fully implement the technological change. This, in turn, makes national borders an obstacle to the absorption of innovation. Summing up, the demographic context can profoundly influence the functional value of constitutional state, as compared to and coexisting with other possible forms of economic governance.

Quantitative research suggests strong, cross-sectional disparities between political systems as for their typical fiscal stance, and those disparities seem to refer mostly to the amount of capital held by the public sector rather than to current fiscal flows. The number of veto players in the political system, possible to be estimated on the grounds of constitutional rules and political polarization, seems to be strongly and positively correlated with the amount of liquid capital held in the natural and temporary possession of public agents.

The more the veto players in the political system, the greater seems the impact of fiscal policy upon some socio-economic outcomes such as the formation of private savings, private investment or primary completion rate. Clearly, what we designate as the efficiency of fiscal policy is very specific regarding the political system in place. In a broader perspective, the present paper comes to a somewhat different conclusion than the seminal work by Roubini and Sachs (Roubini & Sachs 1989). Whilst these authors claimed that fiscal discipline clearly varies across political systems, the present research seems to prove that fiscal discipline is pretty homogenous, whilst the ways which public agents adopt to govern capital in their possession and the outcomes of that governance are clearly system-specific.

On the other hand, qualitative case studies indicate that the capital held by public agents, estimated mostly as public debt and financial assets in the public sector, changes over time in close correlation with the changes in political polarization. Still, at the level of case studies, no visible pattern emerges in cross-sectional correlations in that respect. Any increase in political polarization almost inevitably leads to an increase in public indebtedness and/or endowment of public agents with

financial assets, with a decreasing political polarity acting with an opposite effect. In some cases, that change in the appropriation of financial assets is accompanied by a proportional change in public indebtedness. Yet, national political systems seem to be strongly idiosyncratic as regards the exact share of GDP held as capital by public agents.

Case studies inspire an interesting question, namely that of the relative strength of fiscal and political factors in the shaping of public policies and constitutional orders. Does the amount of capital appropriated by the public sector adapt to the political system, or, conversely, does the political system adapt to the available capital resources? Moreover, is the fiscal stance of the government informative about the actual, partisan structure of the political system? In other words, are substantial shifts in the amount of capital held in the public sector informative about the emergence or disappearance of partisan veto players, not officially disclosed as such? Can we assume, for example, that some partisan veto players start appropriating capital in the public sector even before they have officially emerged as political parties?

A system of economic governance can be judged as distinct from an older one when it is correlated with a significantly different distribution of capital across the social system. A significant change in the respective shares in the available capital stock, appropriated by distinct types of institutionalized organizations, can indicate that a new system of economic governance is emerging.

A tentative claim can be formulated: new forms of economic governance, alternative to constitutional states, will be gaining in importance over the decades to come. Assuring the technological progress necessary to tackle the climate change with all the adjacent challenges might require a much larger than today recruitment of organizations other than national governments.

The economic power of constitutional states, as measured by their capacity to appropriate fiscally the available capital stock, has been on the decrease since approximately 1975. Global technological progress, measured by the index of agricultural productivity, was strongly correlated with the fiscal participation of constitutional states in the capital stock until the early 1990s. Since then, the correlation seems to have been severed, and the global absorption of innovation takes place more and more outside of fiscal stimulation. Demographic growth is slowing down, national markets are growing much more slowly than, say, two decades ago. Constitutional states might represent, right now, an excess of institutional

complexity, and the principle of national sovereignty might become a burden to technological progress rather than a guarantor of legal security.

Constitutional states have emerged as a rational response to the conjoint necessity of stabilizing legal systems and claims on capital goods on the one hand, and organizing the quickly growing populations in limited territories. Other presently observable forms of economic governance, like the libertarian communities or collaborative commons, seem to be antitheses to constitutional states rather than autonomous social inventions. In other words, the present study claims that those alternative forms of economic governance occupy the social space left free by constitutional states as their own.

Any form of economic governance emerges and develops through the institutionalization of past experience. When new forms of economic governance are studied, the main question is: what institutions have taken form on the basis of past events? In other words, whatever a breakthrough a social ideology claims to be, it is always based on what people have actually practised for generations.

Technological progress seems to have accommodated to the institutional change. The fiscal intervention of constitutional states seems to matter less and less for the absorption of innovation. Clearly, other social structures are taking the relay.

We are living a period which, for want of a better word, can be called a "global slowdown". The demographic growth of the global population, as measured by the World Bank, was 1.2% in 2014, as compared to 1/73% in 1990. It means that constitutional states might currently contain, in their institutions, an excess of complexity, and that domestic markets of individual states might not offer enough opportunities for the growth of local businesses and absorption of innovation. National borders might become more of an obstacle rather than a stable benchmark. Interestingly enough, mankind is moving more and more, too. The international migrant stock, i.e. the number of people born in a country other than that the one they live, measured as a percentage of the global population, was 2.51% in 1965 and climbed to 3.09% in 2010. At the same time, economic growth is slow, and likely to slow down even more.

The national case studies of the United States, Bolivia, Mexico, New Zealand and Israel, provide some insight into the possible shapes that capitalism can take. The United States seems to represent a pattern of passive resilience to the surrounding social changes. With a steady flow of immigration, which makes them exposed to a major force of social

change, both the American capitalism and American politics seem to behave like one of those people who, in the face of the coming tsunami, just board their windows and refuse even to move their car to a safer place. Whilst progressively decapitalizing in comparison to China or India, the American economy presents an interesting contrast between the official rhetoric of economic freedom on the one hand and the steadily increasing share of the public sector in capitalistic accumulation on the other. Earlier in this book, it was observed that the global, average share of government expenditures in the national stock of fixed amortizable assets is systematically decreasing. Apparently, that change is taking place outside the United States, which, as a matter of fact, seems to go against that current. The global changes at the intersection of capitalism and political power seem to take place elsewhere. The other four national cases provide some insights into what that change could be. Mexico is an interesting example of inertia by neighbourhood, so to say. Of course, at first sight, both the economy and the political system in Mexico are very different from the US one. Still, the junction between capitalism and political power in Mexico seems to be mimicking the American way, with one major difference: the Mexican political system is obviously not strong enough to accumulate capital as does its counterpart in the United States. The comparison between Mexico and the United States shows how important the real political power of the government is in steering the processes of capital allocation in the economy.

Bolivia is quite the opposite of Mexico and seems to be an example of capitalism and body politic working together in order both to accumulate capital and reinforce political power. The claims, to be found in literature, that Bolivia is a new, "post-liberal" type of constitutional state, might not be as pompous as they could seem at first sight. Bolivia is one of those constitutional structures which successfully absorb capital, both in the private sector and in the public one. In the Bolivian case, finding some kind of a new pattern regarding the political representation of major social groups seems a successful experiment. That pattern is surprisingly resilient to macroeconomic shocks.

Israel and New Zealand are examples of states displaying a clearly decreasing participation in the capital stock available to all the economic actors in the country. Interestingly, in both cases, the decapitalization of the public sector is accompanied by a decreasing capacity of the whole economy to accumulate capital. Even more interestingly, Israel and New Zealand differ in practically every respect. New Zealand is a society close

to homeostasis, Israel is a society constantly on the verge of an open war inside and outside. New Zealand forms its institutions basically in search of institutional excellence, whilst Israel implements institutional reforms in response to dire social and political tensions. A cautious extrapolation can be made at this point: if the majority of governments in the world display a tendency to reduce their capital base, they could be either New Zealand-like, or Israel-like. In other words, the observable loss of economic power in constitutional states across the globe could reflect one of those two patterns, namely either an attempt to arrange a viable pattern of governance in socially stable, relatively small societies (the pattern observable in New Zealand), or a forced adaptation to an extremely turbulent environment, in an attempt to survive despite adversity.

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Capitalism and Political Power presents the author's research spanning economics, law and politics. Its central idea is that governments need two components to consolidate their position: legitimation and economic power. Legitimation is conferred by popular support, and economic power is based on natural, temporary possession of capital. This concept draws on Nouriel Roubini and Jeffrey Sachs' seminal research and on George Tsebelis' political theory, looking at political systems as structures formed by separate political agents – "veto players". Substantial evidence is provided that the more complex the political system is, the more capital it holds, and that the government has only a relative impact on redistribution of capital, decreasing ever since the mid-1980s, as political systems began to move towards simplification and standardization.

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