TULLOCK'S CHALLENGE: A RECONSIDERATION OF CONSTITUTIONAL MONARCHY*

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Resumen: De acuerdo a Tullock (2005, p. 160) la sólida relación entre democracia y progreso económico descansa más en supuestos que en análisis. Tomando el desafío de Tullock de considerar la relación entre progreso económico y diversas estructuras políticas, re-evaluamos la relación entre monarquía y progreso económico. Nuestro análisis se enfoca específicamente en la posibilidad de una «monarquía» constitucional que crea la instituciones en las cuales, comparado con una democracia, un mayor beneficio social es posible. Luego de resumir la conversación monarquía vs. democracia, presentamos una política económica constitucional de la monarquía y la aplicamos al país europeo de Lichtenstein, que ha presentado un rápido desarrollo y una gobernanza no discriminatoria bajo el tipo de constitución que presentamos. Concluimos respondiendo a anticipadas objeciones y proponiendo siguientes caminos de investigación en el tema de la economía política de la monarquía.

Palabras clave: Economía Política Constitutional, Democracia, Eficiencia, Monarquía, Liechtenstein.

Clasificación JEL: H1, H77, P1.

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Abstract: Tullock (2005, p. 160) notes that the perceived robust relationship between democracy and economic progress is due mostly to assumption, rather than analysis. Taking up Tullock's challenge to consider the relationship between economic progress and other political forms, we re-assess the relationship between monarchy and economic progress. Our analysis specifically focuses on the possibility of a «monarchical» constitution creating the institutions within which, compared to democracy, a larger social surplus can be enjoyed. After summarizing the existing conversation on monarchy vs. democracy, we outline a constitutional political economy of monarchy and apply it to the European country of Liechtenstein, which has enjoyed both rapid development and non-discriminatory governance under the kind of constitution we envision. We conclude by responding to anticipated objections and proposing further avenues of inquiry on the political economy of monarchy.

Key words: Constitutional Political Economy, Democracy, Efficiency, Monarchy, Liechtenstein.

JEL Classification: H1, H77, P1.

> [T]here has been a feeling rather than an argument that democracy will lead to greater economic progress [than monarchy]. This is normally based on nothing more than the fact that people believe in democracy and economic progress, and all good things go together. We badly need serious consideration of the matter…
>
> GORDON TULLOCK (2005, p. 160)

I
INTRODUCTION

Although it has been over a decade since Tullock wrote the above,[1] «serious consideration» of the relationship between

[1] The quote original comes from Tullock's 2001 essay, «Monarchies, Hereditary and Nonhereditary,» which was a chapter in the *Elgar Companion to Public Choice*. The version cited here is reprinted as the last chapter in Part II of *The Social Dilemma*.

democracy and economic progress has not materialized, at least not in the sense intended by Tullock.[2] Democracy seems more and more to be accepted as *the* pathway to high living standards, and social well-being more generally. The most economically prosperous nations in the world are democracies; countries that are not yet prosperous or democracies are frequently pressured by the international community, if only symbolically, to democratize, on the assumption that prosperity will follow. More and more it seems as if the preferred response to any «social problem» is more democracy. Subjecting a situation to the rule of the ballot box, the popular wisdom holds, is the most just and effective solution possible. This is unsurprising, given the observed correlation between prosperity broadly defined and democracy, which Tullock noted was the source of faith between economic well-being and democratic governance.

Conceived at the pre-constitutional level, the instrumental value of democracy as a decision rule for collective action, described systematically by Buchanan and Tullock (1962), lies in the diffusion of political power. Democracy, by diffusing political power, makes it more difficultfor any one individual or groups of individuals to use the apparatus of collective action to take wealth from others. However, the possibility of extractive interest group politics suggests that naïve «constitutional majoritarianism» —universal franchise, periodic elections, majority or plurality decision thresholds, and legislative bodies with internal majority decision thresholds (Buchanan and Congleton 2003, p. 25)— should be rejected at the pre-constitutional level.[3] Failure to do so will leave the field of collective action open to rent-seeking, and hence the destruction of surplus.

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[2] By «democracy» we intend the popular understanding of the term: one person, one vote, first past the post. A notable exception is Bjørnskov and Kurrild-Klitgaar (2014), which finds no significant difference in growth between monarchies and republics.

[3] Cf. Hayek (2011, p. 167): «To the doctrinaire democrat the fact that the majority wants something is sufficient ground for regarding it as good; for him the will of the majority determines not only what is law but what is good law.» Chapter 7 of *The Constitution of Liberty*, from which the above quote is taken, is a harsh critique of the effort to extend the range of issues on which the will of the majority is decisive.

It follows that a robust constitution will have significant non-democratic elements. In this paper we take up Tullock's challenge by reexamininghistory's predominant predecessor to democracy: monarchy.We pay special attention the relationship between monarchy and economic progress. Taking «economic progress» to be synonymous with efficiency, we consider this relationship from one of many possible angles: the inclusion of monarchical elements into political constitutions as a method of checking interest group politics through the incentive-internalizing effects of a hereditary executive. In other words, we consider the size of the social surplus within a set of political institutions, but do not consider the tricky issue of transition (transaction) costs associated with moving from one set of institutions to another, e.g. of abandoning democracy in favor of monarchy. Since we are not here engaged in policy advocacy, but instead a theoretical reconstruction of a discredited political form, we do not believe this omission impinges our analysis. It does, however, prevent us from making any sort of recommendations.

To illustrate the importance of non-democratic, and specifically monarchical, features in creating robust constitution, we use as a case study the country of Liechtenstein, which is currently the wealthiest country in the world as measured by GDP/capita. At first glance, this can be attributed to Liechtenstein's tiny population, low corporate tax rates, and loose incorporation standards, which allows foreign firms to incorporate with relative ease and avoid taxation in their own countries. This theory is evidenced by the stark fact that there are more registered corporations than people in Liechtenstein. However, if this is all that it takes for a micro-state to become wealthy, then we would need a theory as to why all microstateshave not adopted similar practices and reaped similar rewards. A promising answer is that the institutional settings of these other countries preclude them from doing so. If this is the case, there must be something in Liechtenstein's institutional framework that has allowed it to reap these rewards. We contend the monarchical aspect of Liechtenstein's constitutional monarchy deserves much of the credit, as it provides sufficient incentive for the Princely House to enact long-term growth strategies that promote the very activities/conditions that lead to their wealth.

Ultimately, we take Tullock's challenge as similar to the puzzle which plagued James Buchanan and continues to plague the field of constitutional political economy: how do we enable the productive and protective state without unleashing the predatory state? (Buchanan 2000). By creating an executive with a vested authority in stewarding the polity's wealth (a markedly un-democratic feature), the effective time horizon of that executive shifts from the short term (e.g. until the next election) to very long term (e.g. in perpetuity).

This paper will proceed as follows: in the subsequent section, we summarize the state of the conversation on monarchy vs. democracy. In addition to highlighting the relevant literature, the economic arguments from section serve as a foundation for our own analysis. In Section 3 we build a constitutional political economy of monarchy, paying particular attention to the idea of monarchy as an element of a constitution featuring a «generality norm.» In Section 4 we engage in a brief but informative case study of Liechtenstein, a tiny European nation characterized by a constitutional monarchy, and whose hereditary executive does possess significant political power, as an example of a successful monarchical constitution. While many have attributed Liechtenstein's success to the fact that it is a known tax haven, this does not satisfactorily answer the ultimate question of *how* Liechtenstein was able to become thus. When juxtaposed with the insight that many tiny states and microstates are not well off materially, this suggests Liechtenstein's unique institution, namely constitutional monarchy, has explanatory power. In Section 5 we respond to anticipated objections. In Section 6 we conclude by suggesting directions for further research on the political economy of monarchy.

II
MONARCHY VS. DEMOCRACY: SUMMARIZING THE CONVERSATION

Olson (1993) cogently summarizes the consensus as to the superiority of democracy over monarchy, and autocracy more generally. It initially appears as though monarchy will result in better governance than democracy, since the monarch, as a residual claimant to the country's income, has an incentive to steward the country's wealth. Democratic politicians, it seems, face no incentive-alignment mechanism as strong as this. However, this is only part of the story.

The monarch qua «stationary bandit» is to be preferred over anarchy, sure enough (Olson 1993, p. 568). The monarch, as an autocratic ruler, will even choose to provide some public goods, guided by nothing more than material self-interest. This decision will of course be based off of the monarch's *private* evaluation of the marginal benefits vs. the marginal costs of the provision of such goods. The end result is to maximize the surplus value the monarch can siphon off from the country. An autocratic monarch «has an incentive to extract the maximum possible surplus from the whole society and to use it for his own purposes. Exactly the same rational self-interest that makes a roving bandit settle down and provide government for his subjects also makes him extract the maximum possible amount from the society for himself (e.g. Kurrild-Klitgaard 2003). He will use his monopoly of coercive power to obtain the maximum take in taxes and other exactions» (Olson 1993, p. 569). However, the incentives for democratic politicians are different.

Democratic politicians must be elected by a majority, and unlike a monarch, these citizens earn income not just through tax-funded transfers, but through participation in the market economy. As such, they internalize the deadweight loss associated with the taxation necessary to fund transfer payments. Olson (pp. 570-571) argues that a democratically-elected politician, constrained by voters' self-interest, solves his optimization problem by choosing a point on the Laffer curve where the marginal increase in tax-funded transfer payments to the representative citizen equals the loss of income he can expect to receive due to the deadweight loss caused by the taxation. The autocrat, as we've seen, chooses the *revenue-maximizing* point, which requires a tax rate higher than the democratically-chosen rate. In other words, the monarch cares only about maximizing tax revenue, irrespective of deadweight loss, since taxation is how the monarch acquires income. Citizen-voters, because they earn income in the market (employment) and through transfers (negative taxes), care about both tax revenue and deadweight loss.

But this is not all. Olson (pp. 571-573) also argues that an autocratic monarch would have a shorter time horizon than a democratic politician, and thus consume his country's capital, enjoying current consumption at the expense of growth and the well-being of the country's citizens. While it's true that autocratically-governed countries sometimes are fortunate enough to see a «liberal» autocrat come into power, the ensuing economic prosperity typically lasts only as long as that autocrat's tenure. A democratic government that incorporates a stable transition from one elected leader to the next, and that protects individual rights to property and a uniform contract law, is necessary for long-lasting economic growth. However, Olson does concede that dynastic succession can lessen the autocratic time-horizon problem by giving the current ruler a stronger incentive to care about the future (p. 572).

Tullock's (2005) classic analysis of autocracy, of which he considers monarchy a subset, also speaks to this debate. Tullock's analysis is somewhat more nuanced than Olson's, in that it recognizes that there really is no such thing as an absolute autocracy, and hence an absolute monarchy: «…[T]he dictator is far from having absolute power. He is, undeniably, the single most important man in the society in which he operates. But he is far from being the mythical absolute ruler of all he surveys. He must always remember that he can be overthrown» (Tullock 2005, p. 48).[4] But Tullock's emphasis is primarily on the choice calculus of the monarch, with less attention paid to the effects of the regime on the country's economic efficiency. Tullock argues that the problem of succession, which plagues many dictatorships, is somewhat ameliorated under hereditary monarchy (p. 102-106). Furthermore, Tullock asserts that the fear of monarchical instability due to succession concerns is overblown. This is because a disproportionate attention is paid to the English monarchy, the most hotly-contested in European history (p. 141). Most hereditary monarchies, or at least European hereditary monarchies, are

[4] See also Wintrobe (1990).

much more stable, as exhibited by the multi-century reigns of the Habsburgs and Hohenzollerns.[5] Thus Tullock's and Olson's analysis dovetail on the social desirability of stable hereditary succession, conditional upon having a monarchy.

When Tullock does consider the question of monarchy and economic efficiency, his analysis overlaps with Olson's. Tullock acknowledges that the interests of monarch and subject would be nontrivially aligned, but recognizes that this is not synonymous with economic efficiency. Tullock, citing Olson, recognizes that the attempt by the monarch to maximize revenue can result in a significant degree of taxation, regulation, and rent-seeking. But Tullock immediately makes an about-face and indicts the «democratic Leviathan state» on this margin as well (p. 154). Tullock concludes by likening the popular fervor for democracy to that of nationalism in the 19th century, which suggests the popularity of democracy is sufficiently unrelated to its efficacy as to render the matter decided. In fact, Tullock asserts that the comparative analysis of democracy and monarchy is an important issue that «has not been given enough serious thought» (p. 160). The head quote of this article speaks to Tullock's view that the robust relationship between democracy and efficiency is more assumption than conclusion.[6]

Other theorists have been more positive on monarchy. The most systematic comparative work on democracy vs. monarchy in the post-war era is Erik von Kuehnelt-Leddihn (1952). Interestingly, Kuehnelt-Leddihn defends monarchy against democracy on the grounds that monarchies are *more* liberal, in the sense of respecting individual autonomy. Liberalism in this sense is not automatically constitutive of economic efficiency, but there are good reasons for expecting the former to yield the latter (Mises 1985). Among the major benefits of monarchy, as compared to democracy, asserted by Kuehnelt-Leddihn are the insulation of a significant sphere of political power from the vagaries of day-to-day political interests; the resistance of monarchs to capture by special interests;

[5] Of course, the territory governed by these dynasties changed due to marriage, succession, and war.

[6] See also Tullock (2002, pp. 261-262).

the ability of the monarch to protect minorities against majorities; and the ability of monarchies to resist the tyranny of the majority, what Kuehnelt-Leddihn calls a «plebiscitarian party-dictatorship» (p. 162).[7] Kuehnelt-Leddihn also asserts that a monarch is more likely to have a longer time horizon than a democratically-elected politician (p. 159).[8] This is not exactly in contrast to Olson and Tullock. Olson worries, and Tullock mentions, the possibility of severe economic hardship resulting from a powerful monarch possessing a short time horizon; Kuehnelt-Leddihn is arguing that it is less likely a monarch will have a shorter time horizon than a democratically-elected politician, which can be justified on the familiar use-value-vs.-capitalized-value grounds.

A less enthusiastic, though cautiously optimistic, defense of monarchy was also penned by Yeager (2011). Yeager explicitly rejects absolute monarchy, instead preferring constitutional monarchy.[9] After summarizing defects in democratic decision-making familiar to public choice theorists, Yeager argues that a monarch can serve as a check on the power of other branches of government (pp. 378-379). Yeager too makes the argument for the benefits of dynastic continuity in lengthening monarchs' time horizons, and also promoting the continuation of the rule of law (pp. 379-380). Among the powers Yeager explicitly calls for in a monarch are the right of pardon, the right to make certain appointments which politicians cannot veto, and (in extreme cases) to dismiss key political figures such as cabinet or prime ministers.[10] Yeager even suggests that, in certain circumstances, the monarch

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[7] These are only a few of the benefits asserted by Kuehnelt-Leddihn. The fourth chapter of the book is mostly a 30-point list of the relative benefits of monarchy, but many of those not mentioned are listed from the standpoint of traditionalist conservatism, and so do not bear directly on this article's main argument.

[8] Hoppe (2001) makes similar arguments, but Hoppe's account is more focused than Kuehnelt-Leddihn's on the implications of the monarch's choice calculus for the size and distribution of the social product.

[9] Where the line ought to be drawn between absolute and constitutional monarchy is unclear. As stated before, even absolute monarchs are constrained in their actions. Rather than beginning an exercise in semantics, we present Yeager's arguments as those most close to the ones we wish to develop.

[10] Yeager assumes a parliamentary system throughout, but his analysis is generalizable to other types of democracy as well.

may appropriately dismiss parliament and call for special elections (p. 384). Yeager does not propose monarchy as a cure-all, but in his conclusion he clearly sees it as a potential improvement at the margin worth exploring further: «Constitutional monarchy cannot solve all problems of government; nothing can. But it can help. Besides lesser arguments, two main ones recommend it. First, its very existence is a reminder that democracy is not the sort of thing of which more is necessarily better; it can help promote balanced thinking. Second, by contributing continuity, diluting democracy while supporting a healthy element of it, and furthering the separation of government powers, monarchy can help protect personal liberty» (p. 386).

III
A CONSTITUTIONAL POLITICAL ECONOMY OF MONARCHY

The previous section has established a number of stylized facts concerning monarchy. The first, and most obvious, are the incentive-aligning features of giving a ruler or governor a residual claimancy on the wealth within a given geographic territory. It is important to note this residual claimancy does not necessarily take the form of taxing power. As Wagner and Backhaus (1987) and Wagner (2012) note, a widespread mode of thought in the fragmented and comparatively-weak German principalities from the 16th to 19th centuries recommended princes raise revenue by employing their lands and other assets in business ventures, rather than taxation. This perspective, called cameralism, was devised as a practical method for instructing rulers how best to raise revenue to improve their domains. Taxation wasadvocated only as a last resort.[11] By owning enterprises within the territory to be governed, a monarch would face similar incentives to the democratically-elected politician described by Olson, since now the monarch participates

[11] Wagner (2012) notes that the cameralists recommended rules for taxation that were far more restrained than the familiar precepts outlined by Adam Smith, which now serve as the cornerstone of public finance orthodoxy.

within the market in order to derive his income, rather than acting *upon* the market via taxation.

Of course, the German princes did not heed this advice out of the goodness of their hearts. Because there were so many principalities clustered in a relatively small geographic territory —the 1648 Peace of Westphalia recognized over 300 sovereign principalities— each of these states was constrained by the possibility of its inhabitants' ability to exit the polity. Despite *de jure* indenture laws that bound the peasantry to the land, *de facto* it was relatively easy for individuals who felt they could work on better terms in neighboring lands to pack up and leave. This operationalization of «voting with one's feet» (Tiebout 1956) forced the German princes to behave as price takers in the provision of governance. This stands in contrast to the great powers of the time, such as Britain and France. In these large and powerful kingdoms, mercantilism prevailed as the method by which the sovereign satisfied his ends of power-maximization for the purposes of regime perpetuation. The great powers, then, were governance price makers, employing taxation as a form of monopolistic political pricing (see Wagner 1997 and 2011) and auctioning off monopoly production rights.

It seems, then, that the behavior of a monarch in Olson's typology is dependent largely on the ability of the monarch's subjects to exit the polity. To state the same concept in different words, the presence of alternatives on the part of subjects is crucial in shaping the monarch's constraints. If this were the limit of the constraints that could be placed on the monarch, perhaps the conversation would be deservedly concluded. Monarchy in this conception would hardly be a robust socio-political arrangement, in the sense that small deviations from ideal conditions would result in significant problems for the overall political-economic order (Boettke and Leeson 2004; Leeson and Subrick 2006; Pennington 2011). However, this constraint, though of obvious importance, does not exhaust the constraints that can be discussed theoretically, nor have prevailed historically. We must discuss the kinds of constraints imposed by the system considered by Yeager, namely constitutional monarchy.

Constitutional monarchy offers the possibility of combining the desirable incentive-alignment features of monarchy with an internal check on the monarch's powers to extract wealth at the revenue-maximizing portion of the Laffer curve. When combined with elements of popular representation, as constitutional monarchies have been historically, it also offers the possibility of the sovereign acting as a check on the democratic-political sector.[12] To analyze constitutional monarchy, it is appropriate to embrace the paradigm of constitutional political economy to see how alternative rules for the relationship between the monarch, and other organs of the state, will affect the overall political-economic order (Buchanan and Tullock 1962; Buchanan and Brennan 2000). In what follows, we assume a formal constitution for simplicity of exposition, but the analysis and accompanying principles are generalizable to informal constitutions as well, as Walter Bagehot's (1867) treatise on the English constitution —itself a proto-exercise in the constitutional political economy of monarchy— shows.

By constitutional monarchy, we mean a system with (at a minimum) the following properties:

1) The monarch is the head of state.
2) The head of state is hereditary.[13]
3) A legislative body fulfils its usual function in drafting legislation, which the monarch has some say in approving in order for the legislation to become law.

Other important features include the presence of an independent judiciary, the degree to which the legislature is popularly elected, the extent of the franchise, whether the monarch's

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[12] See Congleton (2001, 2010) for greater historical detail on this «king and council» model.

[13] While a detailed study of the pros and cons of hereditary succession is beyond the scope of this paper, we should note that the desirability of the hereditary principle is debatable. On the one hand, hereditary succession renders it unlikely that the crown prince is the most qualified individual to rule. On the other hand, hereditary succession is an obvious conflict-minimizing focal point for selecting future rulers (Kurrild-Klitgaard 2000). In addition, it is quite possible that the institutional framework in which the monarch acts is more important than the quality of the monarch per se. For now we assume hereditary succession, both for its historical frequency and its presence in the specific institutional environment of our case study.

check on legislative outcomes is formal or informal, and the degree to which *other* organs of government can check the actions of the monarch.[14]

We believe it is most fruitful to view constitutional monarchy with a view towards Hayek's (1960) ideal of nondiscriminatory governance, and hence the maintenance of the rule of law. The standard is the practice of governance in a manner that no individual or group of individuals is specially discriminated against. This «generality norm» is treated explicitly by Buchanan and Congleton (2003). Their analysis explicitly rejects naïve majoritarianism and seeks to limit the ability of coalitions to impose their will on (and hence extract resources from) minorities. Although the same result could, in principle, be achieved by traditional democratic methods with a supermajority requirement, the proposal of a constitutional check on majoritarian coalitions provides for an element of adaptability to already-existing constitutions.[15] In the context of constitutional monarchy, we see the arrangement promoting the generality norm by (a) creating an apolitical (or at least somewhat insulated from coalition politics) check on political outcomes that (b) has a vested interest in the maintenance of the country's wealth-generating assets and, in virtue of its hereditary component, (c) is likely to result in the exercise of power towards ends of a longer time horizon. To the extent that this prevents the tendencies towards expropriation and rent-seeking on the part of political coalitions, it should also result in a state of affairs that yields a greater degree of surplus created through exchange in society's market institutions. In other words, the value of society's resources (in terms of its numeraire) ought to be higher under this sort of arrangement than alternative arrangements, other things being equal.

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[14] The case we will examine later in the paper features many of these, but we hold only the three criteria mentioned above are necessary in order for the system in question to qualify as a constitutional monarchy. This is not an argument about what a constitutional monarchy «really is,» but an explicit boundary on the scope of our analysis.

[15] See e.g. Salter (2013).

IV
THE PRINCIPALITY OF LIECHTENSTEIN: CONSTITUTIONAL MONARCHY IN PRACTICE[16]

Liechtenstein is a small, landlocked country, located between Switzerland and Austria. It has a total land area of roughly 62 square miles and a population of roughly 35,000. Its tiny size precludes many land-intensive industries from locating there. Interestingly, it is one of but a few countries in the world with more registered corporations than people, due in part to its low corporate tax rate (12.5%) and its simple rules regarding businesses locating their headquarters there. As a result of its broadly laissez-faire governance, Liechtenstein has among the lowest unemployment rates in the world. Between the years 1992 and 2013, for example, the unemployment rate never rose above 5% and, with the exception of 2008, was consistently below 2%.[17] Today, Liechtenstein's income per capita ranks as the highest in the world, at just under $140,000.

Before proceeding with our case study, we believe some remarks justifying the case selection are necessary. First, Liechtenstein is, to our knowledge, the only monarchy where the monarch has retained real political power, but this power is limited constitutionally. In other constitutional monarchies, such as the United Kingdom, the sovereign's role is ceremonial. Second, the existence of microstates that are not well-off economically suggests that Liechtenstein's tiny size does not render it completely unsuitable. One cannot dismiss Liechtenstein's success by arguing that small, open economies rationally choose business-friendly policies, thereby profiting from corporations' decisions to locate there, since many tiny countries have not chosen this strategy. In fact, we argue it is Liechtenstein's unique institutional arrangement in the form of constitutional monarchy that has enabled it to create

[16] Young (2010) also has also written on Liechtenstein, but his treatment explicitly uses Hoppe's (2001) framework. In contrast, our analysis is in the tradition of Virginia Political Economy, i.e. public choice and constitutional political economy as developed by James Buchanan and Gordon Tullock.

[17] In 2008, the unemployment peaked at 3%.

a growth-friendly environment.Third, Liechtenstein has managed to develop under a governance model that, historically, has been susceptible to capture by elites. We feel this anomaly renders the case deserving of special attention.

1. The Constitution of Liechtenstein

Liechtenstein's constitution contains all the elements we require in a constitutional monarchy, and several others besides that improve its effectiveness in creating the conditions that incentivize wealth creation. The constitution explicitly affirms Liechtenstein's status as a constitutional monarchy, with sovereignty shared between the reigning prince and the people.[18] The reigning prince is the head of state[19] and all legislation requires his assent to become law.[20] The reigning prince also has significant power over the appointment of judges, but the judiciary is otherwise independent.[21] The judiciary also has an explicit constitutional court, which exercises its authority in a similar matter to the U.S. Supreme Court.[22]

Liechtenstein has a unicameral parliament (*Landtag*) whose members are elected by the various municipalities. Its function does not differ extensively from other legislative bodies in the developed world.[23] The interesting features of Liechtenstein's parliament lie not in its ordinary operation and formal procedures, but on the checks on legislative outcome by various organs of government. We have already mentioned the reigning prince can veto legislation. In addition, Liechtenstein's constitution offers citizens a method of forcing parliament's hands through direct democracy. Every law passed by parliamentrequiring an increase in government expenditures above a certain amount can, upon

[18] Chapter I, Article 2.
[19] Chapter II, Article 7.
[20] Chapter II, Article 9; Chapter VII, Article 65.
[21] Chapter VIII.
[22] Chapter VIII, Articles 104 and 105.
[23] Chapter V.

the collection of 1,000 citizens' signatures, be forced to be put to a popular vote.[24] This also applies to proposed parliamentary modifications to the constitution, but in this case the threshold is raised to 1,500 signatures.[25] In addition, citizens can force parliament to consider a proposal for legislation, or constitutional amendment, via the same method.[26] For any piece of legislation or constitutional amendment to become law, it must thus attain the assent of the people, parliament, and the reigning prince.[27]

Interestingly, the reigning prince's powers were expanded with nearly a two-thirds' majority support in a 2003 referendum. In this referendum, the reigning prince acquired increased powers over the selection of judges and the blocking of proposed constitutional amendments.[28] In a telling glimpse of the naïve majoritarianism warned against by Buchanan and Congleton, the BBC described this outcome as Liechtenstein's voters deciding «to make their prince an absolute monarch again» (BBC News 2003). They seemingly missed the other parts of the referendum. The people gained the power to submit a petition (1,500 signatures) forcing a vote of no-confidence in the reigning prince.[29] At this point, the sanctions on the prince are decided by other members of the princely family based on its internal House Laws, but can potentially result in forced abdication.[30] Should this prove insufficient, the people have a nuclear option: again with 1,500 signatures, the people can force a vote on the abolition of the monarchy and the transformation of Liechtenstein into a republic.[31] This is one of the only initiatives that the reigning prince is constitutionally constrained from blocking. Finally, the municipalities are guaranteed the right of secession.[32]

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24 Chapter VII, Article 66, Paragraph 1.

25 Chapter VII, Article 66, Paragraph 2.

26 Chapter VII, Article 64, Paragraphs 2 and 4.

27 Chapter VII, Article 65, Paragraph 1.

28 A proposal to limit the prince's veto power amendments was struck down in 2012 with over 80% of the vote.

29 Chapter II, Article 13ter.

30 House Laws of the Princely House of Liechtenstein, Articles 14-16.

31 Chapter XI, Article 113, Paragraph 1.

32 Chapter I, Article 4, Paragraph 2.

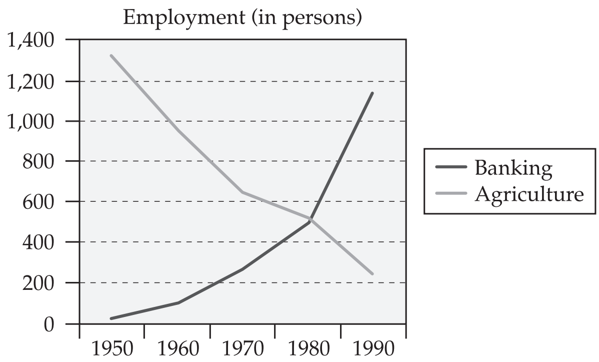
Liechtenstein's constitution obviouslycontains many non-democratic elements. This is a feature, not a bug. But it also contains significant checks on the exercise of this non-democratic power. The combination of these features institutionalizes robustness better than had they existed in isolation. By exhibiting a separation of powers stronger even than that afforded by the U.S. Constitution, and by vesting executive authority in a prince removed from democratic politicking and incentivized to actbased on a long time horizon, Liechtenstein's constitution provided the institutional framework conducive to development. Since the end of World War II, the country has transformed from an agricultural backwater to the nation with the world's highest per-capita income. Many factors contributed towards this rapid increase in productivity, which can be usefully discussed in terms of their approaches towards domestic and international policy.

2. Domestic Policies

Domestically, the people of Liechtenstein benefitted from several liberalizations between 1945 and today. First, as we mentioned, are the low tax rates, which attracted businesses to locate within their country. In fact, Liechtenstein has such a history of being a favorable tax environment that the OECD has officially declared it an uncooperative tax haven because its practices prevent the redistributive goals of a progressive tax structure in other countries from being fully achieved (OECD, 1998; 2001).

Second, due to the small population of the country, other industries, including the financial industry, began looking globally in a quest to earn higher profits. In 1947, the Liechtenstinische Landesbank (LLB), then one of two banks in the country, became a member of the Swiss Bankers' Association, which allowed them greater access to global financial markets. The following year, the other bank located in the country, the Bank in Liechtenstein (BiL) joined as well. As a result of this, the banking sector grew rapidly. Over the span of forty years, the total employment of the banking sector increased almost fifty-fold (Figure 1).

FIGURE 1
EMPLOYMENT BY SECTOR



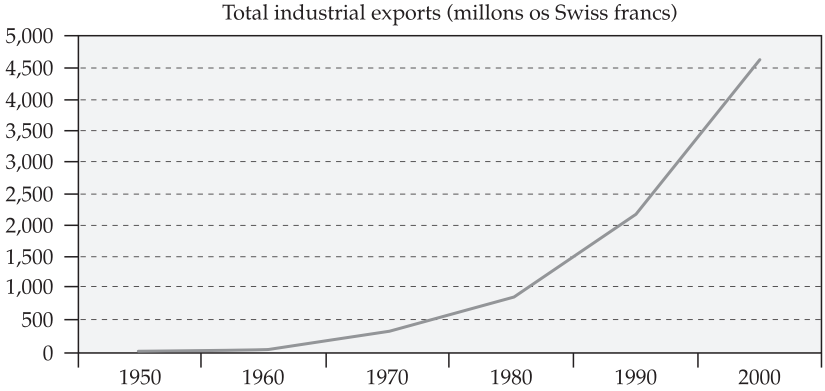
In addition to its financial sector, for which the country is perhaps best known, Liechtenstein also has a thriving manufacturing sector that has arisen due to a variety of factors. Contrary to the popular view of Liechtenstein as a nation of «paper wealth» only, its manufacturing sector is actually the largest contributor to itseconomy. Due to its small size, the country has primarily focused on producing goods that can be exported. Looking at the data since 1950, a clear trajectory of growth is apparent (Figure 2).

Chief among these exports are ceramics used to make false teeth, precision metal components for watches, cell phones, and automobiles, lead crystal giftware, and metallurgy equipment, to name a few. As of 2012, the manufacturing sector comprised 36% of GDP and 38% of the country's jobs, providing the greatest share of economic activity in the country. Despite its small size, Liechtenstein's national economy covers 15 of the 16 international classifications, the only exception being energy production.

While the average cost of starting a business in Liechtenstein is substantially higher than other European countries at €34,200,[33] there are several distinct advantages to setting up a corporation in Liechtenstein over other European countries. For one, in addition to the low corporate tax rate, export-oriented companies based in Liechtenstein enjoy a 7.6% VAT refund since Liechtenstein law

[33] Compared to the UK: €5,650, Spain: €8,040, France: €11,240, Germany: €9,700.

FIGURE 2
TOTAL INDUSTRIAL EXPORTS IN MILLIONS OF 2009CHF



exempts foreign transactions from tax. Even more attractive would be to form a non-profit, charitable fundraising LLC, which pays zero taxes of any kind (income, capital gains, transfer, or estate) and has no requirement of annual financial statements and no personal details about the founder filed with the public register, and can be set up within only a few days.[34] In short, while setting up a business in Liechtenstein exhibits higher-than-average fixed costs, the long-term benefits of doing so are numerous for businesses that wish to trade internationally and among European countries. In fact, according to the Business Names Index of the Office of Land and Trade Registry in Liechtenstein, there are over 73,700 holding companies alone registered in the country – over two holding companies per citizen.

3. International Policies

Having a rapidly-growing industrial sector but a miniscule domestic market, Liechtenstein needed to be able to ensure that trade was as unrestricted with fellow European countries as possible.

[34] This was challenged in 2008 when it was discovered that several German individuals were using these LLCs to avoid taxes, but was ultimately permitted.

Without this assurance, there would be little point in maintaining any sort of business (financial or otherwise) with such a small customer base. To this end, much of the efforts of the 1970s, 80s, and 90s focused on gaining international recognition and support from various emerging international organizations.[35]

The first such event after WWII was the Conference on Security and Cooperation in Europe (CSCE), which officially opened July 3, 1973 and concluded August 1, 1975, which founded the Organization for Security and Cooperation in Europe (Beattie 2004, p. 150). This conference was a meeting among all of the European countries plus the United States and Canada, and had the effect of committing (albeit in a non-binding way) each signatory to build security and cooperation in Europe on the basis of the provisions passed. These provisions were vague, but included items such as a commitment to finding peaceful solutions to disputes at all times, refraining from restricting international trade and actively «reducing all kinds of obstacles to the development of trade,» a commitment to «[developing] road networks and cooperation aimed at establishing a coherent navigable network in Europe,» allowed for easier marriage laws between peoples of different countries, among other items (OSCE 1975). While this was seen as a momentous step in the eyes of the people of Liechtenstein, Prince Franz Josef II recognized that these treaties, while a start, were lacking owing to the non-enforceability of the agreements contained within. The next step would be to join the Council of Europe, which did have provisions for enforcing standards and charters.

From as early as 1962, Liechtenstein officials attended meetings with the Council of Europe but were only able to do so as a part of the Swiss delegation and were not granted any acting rights. This changed in 1974, when they were granted observer status, which allowed their delegates the ability to speak at these meetings however they still lacked any form of an official vote. In 1977, Liechtenstein officials decided to officially apply for full membership to the Council. Initially, this was met with some resistance, owing

[35] Liechtenstein and Switzerland already had a close relationship dating back to a series of treaties signed in the 1920's.

to the small size of the country, with France putting up perhaps the strongest opposition (Beattie 2004, p. 152). After intense negotiation with other member countries, Liechtenstein was finally invited to join the Council of Europe on November 13, 1978 (Beattie 2004, p. 154). This meant two things: first, it formally recognized that Liechtenstein was an independent country of its own and not a canton of Switzerland, as it was typically thought of. Second, it provided them a more direct means of negotiating with international organizations where they previously had to convince Switzerland to do so on their behalf. Joining the Council of Europe provided the assurance that intra-continental trade would remain largely uninhibited.

In order to see continued growth, however, Liechtenstein would need to ensure easy trade regulations on an inter-continental scale. To facilitate this, Prince Hans-Adam II (who began exercising sovereign authority in 1984)[36] began an active campaign to seek membership to the United Nations, first starting with a «spectacular exhibition of the Princely art treasures at the Metropolitan Museum of Art» as a means of showing cultural diplomacy in 1985 (Beattie, 2004 p. 159). Each year for the next five years, Hans-Adam spoke of the need for UN membership, however popular support of this remained lukewarm. The debate raged on, ultimately reaching a constitutional level in 1988, where the Prince and the Government wanted to submit an application to the UN without popular support while the citizens argued that doing so was unconstitutional. Ultimately, after two separate expert opinions commissioned by the Government contradicted each other, it was decided that the Government had sufficient constitutional basis to decide on their own whether to apply for UN membership. In 1989, the Government voted unanimously to submit an application, which was then accepted on September 18, 1990, making Liechtenstein the 159th member of the UN.

By tying the wealth of the crown to the productivity of the general population while simultaneously enabling a greater and

[36] Prince Hans-Adam II's philosophy of governance, decidedly liberal in outlook, can be found in his recent book, *The State in the Third Milennium* (2009). Salter (2014) analyzes the ideas therein from the perspective of constitutional political economy.

more direct means of participation in government for the general population, combined with membership on various international organizations assuring relatively uninhibited international trade, the foundation for Liechtenstein's rise to wealth and prosperity was well-founded. The best available data comes from Andreas Brunhart at the Liechtenstein Institute, owing to the fact that Liechtenstein itself did not keep track of the data themselves. His research suggests that Liechtenstein's national income tripled from 758.2 million CHF (2009CHF) in 1978 to 2,218.3 million CHF (2009CHF) in 1990 (Brunhart, 2012). Per capita income over time is shown below, beginning in 1970, arguably the beginning of the «takeoff» phase (Figure 3).

In addition to this, Liechtenstein's public finances have been quite healthy. Since 1998 (the earliest year that reliable data on this is available from the Liechtenstein Office of Statistics), the country has consistently ran budget surpluses with two minor exceptions in 2008 and 2011 (Figure 4).

This becomes even more interesting when we compare Liechtenstein's deficit to the G7 average. Compared to the persistent budget deficits of the G7 nations —which many see as embodying the democratic-majoritarian ideal— Liechtenstein's surpluses stand out even more (Table 1).

FIGURE 3

LIECHTENSTEIN NATIONAL INCOME PER CAPITA IN 2009 CHF

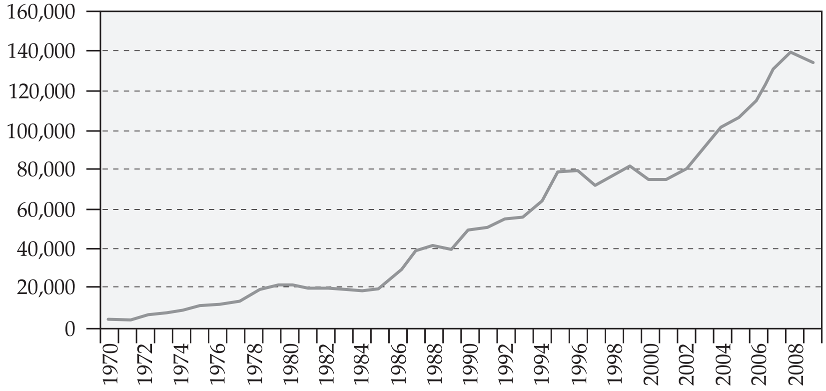


FIGURE 4

LIECHTENSTEIN DEFICIT AS A PERCENT GDP

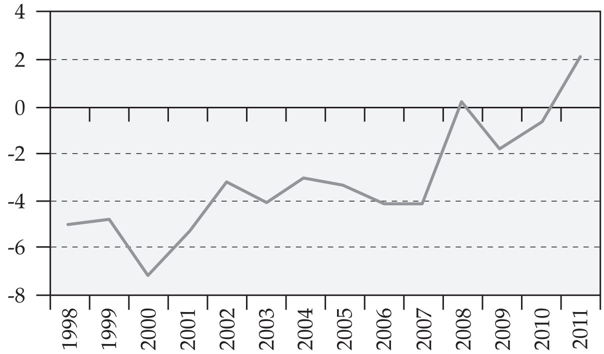


TABLE 1

LIECHTENSTEIN BUDGET DEFICIT (%GDP)
COMPARED TO G7 AVERAGE

Year	*Liechtenstein*	*G7 Average*
1998	-4.9	2.7
1999	-4.7	1.3
2000	-7.2	0.1
2001	-5.3	1.9
2002	-3.2	3.4
2003	-4.0	4.0
2004	-3.0	3.5
2005	-3.3	44.2
2006	-4.2	3.2
2007	-4.2	1.7
2008	0.2	1.5
2009	-1.8	2.9
2010	-0.6	7.6

Given the recent revival in the discussion about budget deficits and the (at least verbal) goal of getting them under control, the effects of Liechtenstein's incentive-aligning executive, combined with other elements that comprise a successful generality norm, on public finance outcomes are particularly relevant.

In summary, Liechtenstein's constitutional monarchy has done an effective job aligning the reigning prince's incentives, making it unlikely his decisions will negatively impact the wealth of the nation. At the same time, the constitutionprevents an excess of discretionary authority through its extensive checks and balances. This two-pronged effort was effective in setting the conditions necessary for liberalization, which facilitated the country's «development miracle» following the end of the Second World War, and especially since the 1970s. We believe it is an illustrative example of a monarchical-constitutional «generality norm» in practice, although we reiterate that research specifically on the generalizability of this governance model is necessary before policy pronouncements can be made.

V
OBJECTIONS AND IMPLICATIONS

Here we respond to some anticipated objections.

Objection 1: «The case study does not speak to the larger theoretical question. Liechtenstein's experience is due to historical accident, the result of complex historical forces following the collapse and break-up of the Holy Roman Empire, and as such is sui generis.»

It is true that Liechtenstein's experience with constitutional monarchy, and the continuance of the institution in a non-symbolic (or, perhaps more accurately, more than just symbolic) form, is idiosyncratic. But we see no reason to conclude from this that we cannot derive any generalizable insights. Calling Liechtenstein's experience a historical accident and leaving it at that does not contribute to our understanding. It is an explanation that does not explain. If Liechtenstein's monarchical constitution can be analyzed using the rational actor model —rational choice applied at the constitutional level— then it is no more or less valid than any other case study.

Objection 2: «The argument is not generalizable to large monarchies. Quasi-cameralist finance methods are appropriate for small polities that are governance "price takers." But large monarchies would pursue mercantilist policies, laying claim to tax revenue and auctioning off monopoly rights,with the accompanying deadweight losses.»

A form of this argument can be read from Wagner (2012) and Wagner and Backhaus (1987). It is true that, historically, large monarchies such as Britain and France have embraced policies that are privately beneficial to governing elites, but costly to an even greater degree for non-elites, and hence are on net socially costly. However, even a casual glimpse at contemporary governance shows that this problem plagues democratic regimes as well. It is an empirical question as to whether rent-seeking and the accompanying social costs are greater under monarchy, where the monarch has an incentive to auction off monopoly production rights and intervene in balance-of-payment mechanisms, than under democracy, which is plagued by the «concentrated benefits, dispersed costs» problem that arises due to the establishment of a commons in governance. We do not even begin to address this question in this paper, although we do believe it an interesting question for future research.

Objection 3: «The argument seems to imply a world of many small monarchies would produce more wealth than the one we currently inhabit. Historically, medieval Europe was characterized by an intranational and international order seemingly similar to that considered in the paper. If the authors' argument is correct, how then do we explain the persistent poverty and miniscule growth in medieval Europe?»

First, it is another question entirely —one that would require several papers— whether «a world of small monarchies» would, all else being equal, out-produce the status quo. We do not believe our argument necessarily implies such a conclusion. Putting aside these concerns, we can still address the question in the objection's final sentence. We will answer by way of analogy. Leeson (2007) and Powell et al (2008) have shown that Somalia, after the collapse of its government, has seen its living standards rise. Somalia's governance possibilities were so poor under a nation-state that anarchy was welfare-enhancing. One does not need to be a universal anarchist to embrace this claim. Instead, all one must do is recognize the tradeoffs associated with state and non-state governance, and always keep the central question of economics in mind: «Compared to what?» The same can be said concerning the comparison between medieval Europe and modern Liecthenstein. The ceteris are certainly not paribus. The poor economic performance of medieval Europe, compared to today, can be attributed to many factors, among which was general insecurity of property rights. Whether this instability of property rights is endogenous to monarchy, and if so under what conditions, is a crucial question. The answer is not obvious, and we cannot consider it further here. Again, we are hopeful that future research projects will address this issue.

VI
CONCLUDING REMARKS

If our analysis is correct, there are several important implications. The first concerns Acemoglu and Robinson's (2005) theories concerning the transition from dictatorship to democracy, and the related literature. Acemoglu and Robinson hold that dictatorships transition to democracies when non-elites obtain sufficient coercive power that they can force elites to engage in durable (institutional) pro-democratic reforms. They also argue that as economies get richer, capital and industry become more important relative to land and agriculture in the determination of national income, which implies that elites' resistance to democracy diminishes in the face of economic progress. This suggests a robust and generalizable relationship between democratization and economic growth. This is also implied in the importance Acemoglu and Robinson (2012) place on inclusive institutions for national progress. Our analysis suggests we treat this claim with caution. While it is true that democratization can disrupt elites' privately beneficial but socially costly behavior, it can also create new opportunities for thisbehavior due to rent seeking, along with other problems that arise due to concentrated benefits, dispersed costs mechanisms. Our analysis suggests that political elites can play a productive role in stemming the social costs associated with democratization, *provided incentives are properly aligned*. It also challenges the idea that inclusive institutions result from concessions from political elites. In the case of Liechtenstein, inclusive institutions developed with the guiding hand of the monarch, precisely because of incentive alignment. This is even more obvious when we remember that the non-democratic aspects of Liechtenstein's constitution remain immensely popular among ordinary citizens.[37]

The second concerns the relationship between democracy and economic growth more generally. The empirical literature on this is enormous; even the summaries of the existing literature are too numerous to discuss in detail. A recent «meta-analysis» of this literature (Doucouliagos and Ulubaşoğlu 2008) suggests that there is no clear relationship between democracy and economic growth. The authors note that democracy does seem to contribute secondary effects to growth, through increased human capital, lower inflation rates, less political instability, and more economic freedom. But they also note that democracies are apparently associated with a larger public sector and restrictions on international trade. Our analysis suggests the possibility of the «right» amount of democracy. Liechtenstein is not non-democratic —elements ofboth direct and representative democracy are prevalent— but does have significant non-democratic constitutional features. An intermediate amount of democracy can be effective in disrupting elites' attempts to create institutions and policies that are privately beneficial but socially costly. But it must remain intermediate, lest rent seeking and other problems abounddue to familiar public choice reasons. In other words, the «optimal» level of democracy disperses political power among sufficiently heterogeneous agents such that one group finds it difficult to benefit at the expense of other groups politically, but not so much that commons problems in governance outweigh these gains. Liechtenstein seems to have found a happy medium, with elements of direct democracy combined with monarchical veto power at the legislative and constitutional level.

Despite the constitutional analysis contained here, we need to know more about the general conditions under which a monarchy is expected to be superior to a democracy. Answering that question is necessary since constitutional monarchy of the kind enjoyed by Liechtenstein may not be in polities' institutional possibility set.

[37] Whether this means such aspects «really are» democratic is a difficult question best treated elsewhere, but we will note that expanding the definition of democratic to this degree seems to rob the term of much of its useful content.

Research on this will undoubtedly involve engaging the literature on the harmony, or in unfortunate cases the lack thereof, between formal and informal institutions prevalent in a society (e.g. Coyne and Boettke 2006; Williamson 2009; Williamson and Kerekes 2011).

A crucial margin of analysis will undoubtedly be the size of the polity, as mentioned above. It is probable that the revenue-maximizing strategy of the sovereign switches from one that is broadly cameralist —the monarch using his property within a market order, maximizing its value by participating in and contributing to the stability of that order— to one that is broadly mercantilist —acting on a market order through taxation and the auctioning off of special privileges— at some size threshold. We need some measure of addressing how quickly social costs increase at this threshold compared to the similar threshold in democracy.

There is also the question of property rights stability under monarchy, which is crucial for understanding how monarchies will behave with respect to other polities. This question must be answered before any sort of pronouncement can be made on the desirability of multiple competing monarchical sovereigns. If it turns out that the conditions that incentivize monarchs to prey on other polities are numerous, it will be less likely that real world monarchies will result in a larger social surplus. This will involve comparing the monarch's net benefits from waging war, the most familiar form of predation, to that of the monarch's elected and temporary counterpart. An elected executive will probably receive both lower benefits and incur lower costs from waging war, but this leaves *net* benefits undetermined.

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