



Simple rules for the developing world

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Abstract

Much of the discussion in favor of simplicity of legal rules and against complex regulation is rooted in economically developed countries with strong state capacity. With economic development and state capacity comes the presumption that complex rules will be enforced. Therefore, analysis focuses on the administrative and error costs, and the unintended consequences of complex rules that are enforced. This paper argues that the Epsteinian insight is even more relevant to the developing world where countries often lack enough state capacity to even take on simple governance tasks. Developing countries often have less than 20 percent of the state capacity of developed countries. However, this does not mean they limit the regulatory structure to a fifth of the tasks. Under-enforcement or non-enforcement of complex rules imposes different costs and unintended consequences on society. Using examples from India, this paper highlights problems of enforcement swamping, deadweight loss, and corruption arising from the under-enforcement of complex rules. To avoid these problems, the paper concludes that *a fortiori* less developed countries should favor simple rules.

Keywords Complex regulation · Under enforcement · State capacity · Simple rules · Presumptive laissez faire

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1 Introduction

In *Simple Rules for a Complex World*, Richard Epstein (1995) argues that the complexity imposed by the American regulatory system, in virtually every area of economic activity, creates private costs of compliance, public costs of enforcement, and social costs related to uncertainty; which, in aggregate, are likely to exceed the benefits from regulation, and undermine the overall functioning of the market system. There is a large literature analyzing the “optimality” of individual rules in different fields of law, while Epstein argues that aiming for optimality with individual rules in each situation might lead to an overly complex system overall. Since its publication twenty-five years ago, these ideas have become an integral part of the economic analysis of the regulatory state in the US.

Outside the US, the insights from the *Simple Rules for a Complex World* framework, have mostly been applied to the developed world, like the European Union (Elert et al., 2019) or Australasia (Teicher & Svensen, 1997). With economic development and strong state capacity comes the assumption that the complex rule in question will be enforced. Thus, the law and economics literature mainly focus on the incentives associated with a given rule and its unintended consequences assuming the rule is enforced. The focus here is on the accumulation of rules and growing complexity that can overwhelm limited state capacity making many of the rules only inconsistently enforceable.

In this paper we extend Epstein’s insights to the 6 billion people in the world who live in weak or fragile states. A majority of the global population encounters governance systems that lack the capacity to enforce complex rules. We argue, that Epstein’s insights are even more applicable to countries with weak state capacity, and problems related to underenforcement or non-enforcement of complex rules in these conditions.

There are three main concerns posed by complex rules in weak states. First, these rules are not fully enforced, and there are unintended consequences of non-enforcement or arbitrary enforcement of existing rules. Second, creating and complying with these rules, even partially, imposes additional stress on the administrative and enforcement systems. Consequently, there is premature load bearing (Andrews et al., 2017, Rajagopalan & Tabarrok, 2019), enforcement swamping (Klieman, 1993) and increased subversion and corruption of the political and legal system (Glaeser & Shleifer, 2003) – under-recognized costs and consequences of a complex regulatory framework. And third, because premature load bearing leads to poor consequences, and too many violations, to compensate for weak state capacity, these states impose further complex regulation, especially with criminal penalties. Andrews et al. (2017) argue that the gap between the capability required to implement the complex regulation and the capability achievable in weak states imposes significant stress on the system. And this stress pushes these developing countries into a path of even lower state capability. Prematurely adopting complex rules with limited state capacity can reduce the ability of weak states to actually develop greater state capacity.

In the following sections, we first review Epstein’s argument of the costs associated with complexity in a world where complex rules are enforced or expected

to be enforced in strong states. Second, we discuss weak and fragile states, where the state capacity cannot possibly enforce such a complex regulatory framework, though they might feel pressure to adopt complex regulatory rules. Third, we discuss why countries like India, with weak state capacity, adopt complex rules, and the three consequences and costs related to non-enforcement of complex rules. We conclude with a simple message—when there is weak state capacity, Epstein’s message of presumptive *laissez-faire*, is even more relevant.

2 Complex rules in strong states

Individuals are vulnerable to predation by other individuals and predation by the state. Typically, structures, and rules at a higher, perhaps constitutional, level are written to protect individuals from public predation. The purpose of law, viewed from this point of view, is to create desirable incentives for individual action, such that they minimize private predation, usually within a broader institutional/constitutional framework that limits public predation. A bulk of legal rules and regulation, especially the rules codified from the common law tradition, help protect individuals from private predation and nuisance. The regulatory state in most developed countries has moved beyond the simple common law system to complex regulation trying to reduce if not completely prevent socially undesirable behavior by individuals and firms.

Epstein’s argument on the costs of regulatory complexity describes the trade-offs involved (1995, p. 30–36). No rules, or too few rules, governing individual behavior may mean a very simple legal system with low cost of enforcement, but one with socially undesirable behavior and high costs associated with private predation. On the other extreme, too many rules, and too much complexity associated with the interplay of those rules, change the problem to one with potentially very little socially undesirable individual behavior, but very high cost of enforcing those rules, and a relatively high degree of power exercised by the state over the individual.

Complexity has compliance costs and enforcement costs. All else held equal, simpler rules that are clear and well publicized will require low private costs of compliance. The more complex the rules, the greater the cost of compliance. The more complex are tax rules, for example, the greater the need to keep detailed records and hire experts. Second, is the cost of administration by the state. Once again, the simpler the rules, the lower the public cost of administration—all else held equal. Both costs—the private cost of compliance and the public cost of enforcement—can rise non-linearly. With two “Yes” or “No” rules there are four cases to consider. With three rules there are 8 cases to consider and with ten there are 1024 different possible cases making complexity an exponentially rising problem.

Error costs must also be considered. Epstein (1995), for simplicity, includes these in the cost of administration. But we believe error costs merit greater attention, whether or not intended maliciously or systemically by the state. In any regulatory system, there will be two kinds of potential error: Type I error or false positives, and Type II errors or false negatives. Total error cost is the sum of all false positives and false negatives produced by the system.

It is possible that while regulating civil violations, the two kinds of errors are symmetric. The errors of wrongful fines or (false positives) may proportionately reduce the costs associated with false negatives or not fining the wrongdoers. In addition, fines are transfers and can be used to lower other state costs. But criminal sanctions are not symmetric and do not result in reduced costs elsewhere. For criminal law enforcement, the costs of a false positive that results in wrongful imprisonment is greater in magnitude than a false negative (erroneous acquittal), as reflected in the ancient aphorism that “it is better that ‘n’ guilty men go free than one innocent man be wrongly convicted.” In addition, criminal sanctions are net social costs and not transfers. A fine can be used to lower taxes but no one’s taxes are lowered when a criminal is sentenced to prison.

There is a trade-off between the two types of error, which is of key importance while designing the regulatory system. Usually, for criminal sanctions that involve a prison sentence, the systems are designed to minimize false positives. On the other hand, regulation related to taxes and revenue collection, tend to minimize false negatives.

Finally, there are deadweight costs, associated with any particular regulation or regulatory system. The simplest way to think about deadweight costs is the loss of desirable economic activity because of a regulation or tax. A tax on train tickets, for example, reduces the number of train trips. The deadweight loss is not the tax paid to the government by the value lost from trips not taken. Tax revenues are seen but deadweight losses are unseen and the relationship between tax revenues and deadweight losses is not linear. A very high tax may raise very little revenue and yet because of actions not taken have very large deadweight losses. Deadweight losses are unseen because they flow from actions untaken and may be double unseen when there are downstream consequences. Stringent visa procedures, for example, will discourage people from applying for a visa for legitimate business or tourism purposes. Estimating lost trips may be possible but estimating the the resulting loss of economic activity—hotels not occupied or built, restaurants empty or non-existent, taxi’s unfilled or never operated is even more difficult. Complexity itself can be a tax and an especially negative tax because complexity raises no revenues yet deters valuable economic activity. Moreover, the complexity tax is especially difficult to see because it adheres not to any single regulation but to the system itself.

3 Weak states

While discussing each of these costs – private costs of compliance, public costs of enforcement, error costs, and deadweight losses – the central assumption is that these rules are mostly or fully enforced by the state. And more importantly, individuals in these societies expect that these rules will be enforced. In weak states neither of these assumptions hold true and this changes the analysis of complex rules, reducing some costs but increasing others.

State capacity is the ability of the state to effectively design and implement its own policies. There are strong states, which can execute almost all of their rules, no matter how complex, effectively. On the other extreme, are countries usually

categorized as very weak or fragile states, with little to no ability to execute their policies. In the middle are weak states.

But how does one measure capabilities of states and more generally efficiency of the government in executing policies which are different in scale and complexity? One simple and elegant study to understand differences in state capacity is by Chong et al. (2014) which examines the differences in how well countries handle international mail. 159 countries in the world are signatories to the Universal Postal Union Convention, which specifies a common policy for the treatment of undeliverable international letters. Among other requirements, they are to be returned to the sending country within thirty days. A functional postal service and returning an undeliverable letter back to the sender is not a complex rule, but it does require state capacity to execute the rule as intended. More importantly, the *de jure* policy on returning letters is exactly the same across all 159 countries, so the difference in the efficiency and performance of each countries postal system is not about differences in rules. Thus, we will use the percentage of letters returned as a measure of state capacity.¹

To examine governmental effectiveness, Chong, et al. (2014) mailed 10 deliberately misaddressed letters to five different cities in each of the 159 countries and waited and counted how long, if at all, each letter took to return. Measured by the number of letters which were returned within ninety days (already more than the official policy of thirty days), the performance ranged from zero to 100%. In countries like Finland, Norway, and Uruguay, 100 percent of the letters came back within 90 days. In 25 of 157 countries, no letters came back within 90 days (in 16 countries, none of the letters came back ever). These zero performance countries included unsurprising states like Somalia, Myanmar, and Liberia but also included “middle-income” countries like Egypt, Fiji, Ghana, and Honduras.

Various studies have measured the ability to execute other essential state functions and the answer tends to be correlate with the letter rule. Some 140 countries, for example, are signatories to the Global Convention on the Rights of the Child which commits them to register all children at birth. However, even twenty-five years after this international commitment, countries such as Bangladesh, India, Mozambique, Nigeria, Pakistan, and Uganda still register less than 40 percent of children at birth. The inability to accurately count and record births and deaths and provide a document that is used for the identification and targeting of virtually all other government programs is a classic example of weak state capacity.

The inability of a state to ensure that people with driver’s licenses are competent drivers is another example of a weak or flailing state (Pritchett, 2009). According to India’s road transport and highways minister Nitin Gadkari (ET Bureau, 2019), for example, 30 percent of India’s driver’s licenses are fake. This may underestimate the problem as many real licenses are obtained in a routinely fraudulently manner without taking a test which many people would fail (Bertrand et al., 2007).

To measure state capacity across countries globally, Andrews et al. (2017) average a scaled index of three different data sources—Quality of Government (QOG) data, Failed State Index (FSI), and World Governance Indicators (WGI).

¹ See also Acemoglu et al. (2016), Geloso and Makovi (2020) and Hanson and Sigman (2021) on post office and letter rules as measures of state capacity in different contexts.

After scoring the developing countries using these three, they categorize the countries as strong, middle, weak and very weak. Most people in the world live in middle or weak capability states and almost half (49 of 102) of the historically developing countries have very weak or weak capability (Andrews et al., 2017, p.11). Only eight of the historically developing countries have attained strong capability. Moreover, as these eight are mostly quite small (e.g. Singapore, Bahamas, United Arab Emirates), fewer than 100 million (or 1.7 percent) of the roughly 5.8 billion people in historically developing countries currently live in high capability states. (*Ibid*). Just the number of people living in weak states makes this a prevalent and important problem.

This is a snapshot at a moment in time. But state capacity can be built, and perhaps signing these conventions or adopting complex regulatory systems in labor, health, anti-corruption etc. today will be enforced well in due time as developing countries develop capacity. Unfortunately, weak states are not growing in capacity.

Andrews et al. (2017) also calculate the number of years each country will take (at their current rates of capacity growth) to become a state with strong capacity. They find a few unambiguous successes in building state capability like South Korea, Chile, and Singapore. But only another eight countries are, if current trends were to persist, on a path to reach strong capability within this century. Andrews et al. (2017) conclude that at current rates, less than 10 percent of today's developing world population will have descendants who by the end of this century are living in a high capability country. For the other 90 percent the situation is bleaker. The "business as usual" scenario would end the twenty-first century with only 13 of 102 historically developing countries attaining strong state capability. At the other extreme, seventeen countries are at such a low level of capability that even "stateness" itself is at constant risk—in Somalia, Yemen, and DRC, and more recently added Syria. The basic point can be illustrated by the fact that most developed countries delivered letters and registered births and deaths reasonably accurately in the nineteenth century and many developing countries have not yet achieved this level of capacity.

Andrews et al. (2017, p.25) find that for the middle states there is an even more disturbing trend. Among those countries with minimally viable states, fifty-seven of the seventy-seven (three-quarters) of the weak and middle capability countries have experienced a trend deterioration in state capability since 1996. Twelve of the sixteen largest developing countries—including China, India, Pakistan, Brazil, Mexico, Egypt, Vietnam, the Philippines, Thailand, and South Africa—had negative trends in state capability.

In other words, weak state capacity is the norm and not the exception. And there are very few states on the path to build capabilities to overcome the problem. This has important consequences for complex regulation. A state that cannot follow simple and universal rules like "return to sender", or implement the basic policy of recording births, will scarcely be able to implement and enforce complex environmental regulation, labor regulation, or health and safety protocols.

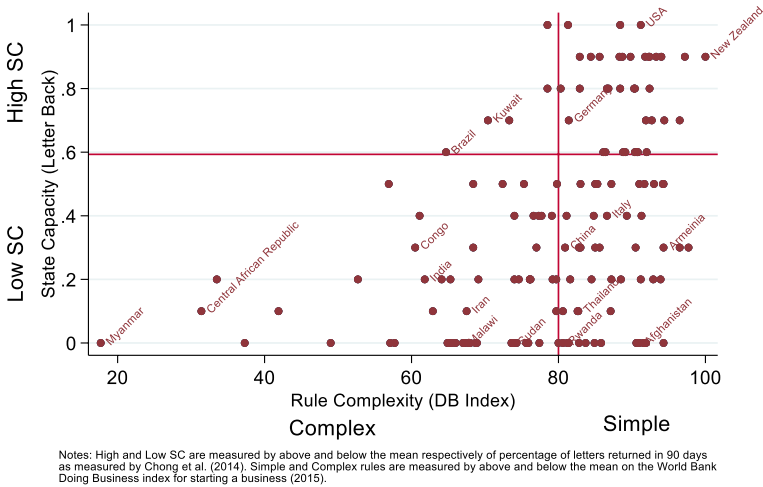


Fig. 1 State capacity and simple rules

4 Many weak states have complex rules

There is little chance that weak and middle countries can actually enforce a complex regulatory system. But does that mean these countries de facto operate in the Epsteinian world of simple rules? In other words, does weak state capacity solve the problem of moving these countries from de jure complex rules to de facto simple rules? Unfortunately, no.

States with weak capacity could conserve their capacity on the most essential functions and ignore more complex regulatory issues either de facto or de jure (Rajagopalan & Tabarrok, 2019). But in practice weak states have as much or more regulation than strong states (Djankov et al., 2002) and try to enforce everything (Pritchett, 2009, Andrews et al., 2017). In the process, they fail not only at enforcing complex regulations but also degrade many fundamental state functions (Rajagopalan & Tabarrok, 2019). It’s not surprising from this perspective that Andrews et al. (2017) find that in many states with low state capacity, state capacity is diminishing. In this sense, there is a massive social cost to non-enforcement of complex rules, which are different from the costs of enforcing complex rules.

In Fig. 1 we illustrate the relationship between state capacity and complex rules. We measure state capacity on the vertical axis using the percentage of letters returned within 90 days (Chong et al., 2014). As discussed earlier, letters are an old technology and following the international postal rules is easily achievable without high technology or high GDP. Thus, the Chong et al. (2014) is a good measure

of state capacity.² We measure rule complexity along the horizontal axis using the World Bank's summary index of Ease of Starting a Business (2015) which summarizes the number of procedures, cost and complexity of opening a new business.³

Figure 1 shows that there are notably few states with high state capacity and complex rules (Brazil and Kuwait being exceptions). Why? One answer is that one of the things that high state capacity states do is simplify rules. Historically many high capacity states have simplified and eliminated local rules and monopolies to create large national markets governed by the rule of law (Johnson & Koyama, 2017). Bogart and Richardson (2009), for example, show that it was the increased capacity of the British Parliament brought on by the Glorious Revolution that allowed it to eliminate complex feudal constraints on the buying, selling, leasing and mortgaging of property, greatly increasing efficiency and contributing to the British agricultural revolution.

Figure 1 also shows that many states with low state capacity and complex rules, including states such as the Central African Republic, the Congo, Iran and India. There are also many states with low state capacity and simple rules, such as Thailand, China and Italy. Combined with the lack of states with high state capacity and complex rules this suggests that simplifying rules tends to happen before large increases in state capacity. In other words, state capacity and simple rules evolve together but from the perspective of Fig. 1 in a predominantly counter-clockwise direction.

Our main interest is in the low state capacity, complex rules quadrant (bottom-left). States in this quadrant are doubly harmed. Complex rules without a state capable of enforcing the rules, a recipe for a flailing state. We verify this intuition in Fig. 2 which shows GDP per capita (\$2012) by high or low state capacity and complex and simple rules. In other words, each bar corresponds to a quadrant in Figure One. States with low state capacity and complex rules have the lowest average GDP per capita. Low state capacity states with simple rules perform markedly (80 percent) better as do states with high state capacity and complex rules (noting that the sample size in this quadrant is small). But the big leap is with the combination of high state capacity and simple rules. Thus, simple rules appear to be necessary or nearly necessary but are not sufficient for high GDP per capita.

The intuitions developed in Figs. 1 and 2 are tentative and correlational. We turn now to a deeper, case-study of India as a state with low-state capacity and complex rules. Why does a state have rules that it cannot enforce? What are the consequences and how can it move towards simpler rules and eventually to higher state capacity?

² Our results are similar using the Hanson and Sigman (2021) index of state capacity which correlates with the Letters Returned measure at $r = .6351$. See also Hanson and Sigman (2021) for similar regression results.

³ The World Bank has recently released the findings of the investigation into irregularities in the Doing Business 2018 and 2020 reports (Machen et al., 2021) on the allegations that the rankings of countries like China and Saudi Arabia (2018) and Azerbaijan and UAE (2020) were manipulated in 2018–2020 for political reasons. We use data prior to any alleged manipulation and our results do not depend on Azerbaijan, China, Saudi Arabia and UAE.

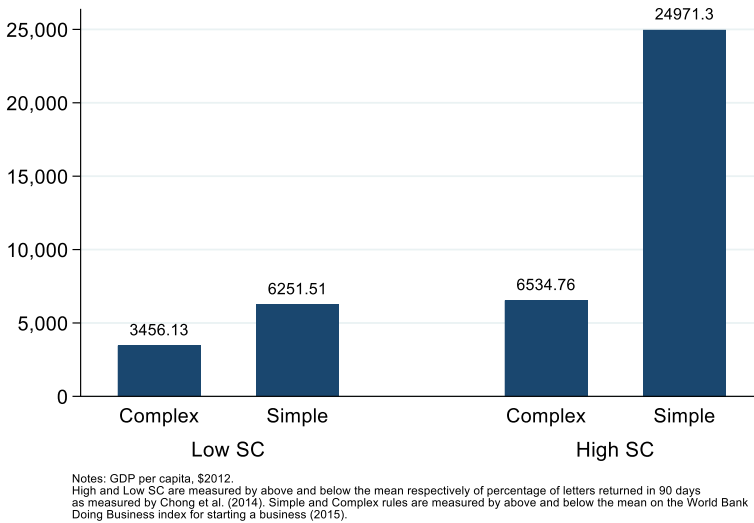


Fig. 2 GDP per capita by state capacity and rule complexity

5 Reasons for complex regulation in weak states: a case study of India

Though low state capacity and complex rules are a bad combination seen in weak and fragile states with poor living conditions each has a historical and contextual reason for how these complex rules came to be. Sometimes it is a remnant of a different economic system like socialist planning, or because of rules imposed by colonial governments, or imposed by multilateral organizations, or lingering rules and controls from past wars, or in some cases, a consequence of the inability to implement existing rules. Because of different history, context, culture etc., it is important to look at individual countries, regions, even specific rules to better understand the weak state-complex rules regimes.

India is, by an order of magnitude, the largest country trapped in the weak state-complex rules quadrant. India has essentially all the regulations of a country such as the United States and then some. Of the six billion people living in countries with low state capacity, home to 1.35 billion, India merits greater attention in the literature on the desirability of simple rules in complex systems. We detail three reasons for complex rules in India and some of its consequences.

Countries with weak states may have complex rules (the worst combination) because they inherit complex rules either because this is the norm or because of a colonial or socialist transition. Countries may import complex rules from strong states because of isomorphic mimicry and premature imitation. And finally, complex rules may grow in weak states especially perhaps in weak states with democratic governance.

5.1 Inheriting complexity

The history of Europe suggests that complex rules, not simple rules, are the norm and that strong states are one means by which simple rules are imposed. Johnson and Koyama (2017), for example, argue that sweeping away ages-old complex rules in place of open, national markets required strong but limited states—what Acemoglu and Robinson (2020) call the narrow corridor. Moreover, the often violent and costly path to the narrow corridor was different in different times and places and thus difficult to generalize. Historical contingency was important but so were deep roots. The Philippines and South Korea were both extremely poor in 1960 but Korea had a long history of continuous statehood prior to colonization while the Philippines has only rarely been unified (Johnson & Koyama, 2017). South Korean growth may have been miraculous, but some miracles are easier than others.

North, Wallis, and Weingast (2012) distinguish between limited access orders and open access orders. The former is dominated by a “predominance of social relationships organized along personal lines, including privileges, social hierarchies, laws that are enforced unequally, insecure property rights, and a pervasive sense that not all individuals were created or are equal.” Open Access Orders, on the other hand are characterized by “widespread, impersonal social relationships, including rule of law, secure property rights, fairness and equality—all aspects of treating everyone the same.” India is transitioning between these two orders.

Though India is dubbed one of the oldest civilizations, until the mid-twentieth century, it was a collection of smaller states that can be characterized as limited access orders. In the last few thousand years, there are examples of rulers like Ashoka and Akbar who ruled over large parts of the territory that forms modern day India but even during empire periods it was largely governed by smaller, regional rulers, with power relations determined by religion, caste, language, ethnicity, and political alliances (Chatterjee, 2022). And each of these regional monarchies and tribes brought with their customs and traditions the hierarchies and power structures that determined the relationships of individuals with each other and the state. And though they varied in their degree of centralization, almost all of them (other than some independent tribes) can be classified as limited access orders. The people were not sovereign and whether one could establish new organizations depended on who one knew.

The British also largely governed through personal hierarchy in the regions which they controlled directly and through Indian elites in other regions. In short, rather than establishing an open access order, the British changed who you had to know but not that you had to know someone. The British reliance on personal relationships and elites only increased after the uprising in 1857 (Matthews, 2021). Thus, India as a nation state, begins only in 1947 and it begins with hundreds of year of limited access baggage making a transition to an open access order difficult.

At the time of independence in 1947, India was a highly fractionalized society. Politically, the Indian framers faced the challenge of incorporating the 562 princely states, which, for the most part had their own monarchic traditions, and the British territories under a single constitution (Menon, 1998). Even after the partition, 12 percent of the population were Muslim, while other religious minorities included

Christians (2.5 percent), Sikhs (almost 2 percent), and Buddhists, Jains, and Parsis (together comprising about 2.5 percent) with Hindus comprising the remaining 80 percent. Caste was another area of division, with the British categorization of oppressed and backward castes and tribes comprising almost a fifth of the population. India was home to nearly twenty major languages, each of which was spoken by at least one million people. The total number of represented languages and dialects exceeded 1,600.

The Indian Union had to be stitched together keeping in mind these circumstances and interests. It took almost three years to draft the Indian Constitution and negotiate the rights and agendas of this highly fractionalized and complex society. During those three years of deliberation, the Indian Constituent Assembly moved, discussed, and voted on 2,473 amendments out of a total of 7,636 tabled amendments to the drafts of the constitution. The result was the world's longest constitution with 395 Articles and eight schedules adopted in January 1950.

With independence from the colonial government, and a new constitution in 1950, India began to make the transition from a limited access order towards an open access order. The first was a transition to a constitutional republic where the people were sovereign. Second, the fundamental rights chapter in part III of the Indian constitution guaranteed equal protection under the law, in addition to protecting life, liberty, property, free speech, religious expression etc. Third, was determining the basis for citizenship. The choice was among two different kinds of citizenship in the legal sphere: *jus sanguinis* (descent or blood-based kinship ties as a basis for citizenship) and *jus soli* (birth based citizenship). Despite being debated during a bloody partition between India and Pakistan, India's constitutional framers made the "enlightened modern civilised" (Constituent Assembly Debates, III, p.424) choice and democratic conception of citizenship, as opposed to "an idea of racial citizenship" and the Citizenship Act 1955 gave a statutory basis to the idea of *jus soli* or citizenship by birth. However, the social upheavals during partition undermined *jus soli* outside the enlightened group forming the constituent assembly and India has been moving from from a *jus soli* or birth-based principle of citizenship in the direction of a *jus sanguinis* or descent-based principle (Jayal, 2013).

Fourth, and one of the most important practical aspects of the transition, was that the Indian republic granted universal adult franchise from the beginning. No Indian had the right to vote until the early twentieth century and even in the 1940s, the franchise was highly restricted. Even the Constituent Assembly of India was selected not on direct adult suffrage but indirectly by members of provincial legislatures themselves elected by the very limited franchise of the 1946 provincial elections. In the first general election in 1951, for the first time, subjects became citizens armed with voting franchise.

These aspects of the Indian republic helped transition from a limited access order towards an open access order. But because of the complexity in creating the Union of India, and holding it together, each element—constitutional rules, rights, administrative procedures, federal system— were created with numerous exceptions.

In addition to religious, caste, cultural, linguistic, and political diversity there was added the complexity of economic controls. India inherited the rules of the colonial state which had been designed to extract resources and serve British

needs. British extraction accelerated during the second world war with the enactment of the Defense of India Act of 1939. These rules detailed the complete control of markets by the state and provided for the appointment of a controller for each commodity at a provincial level. More controls and restrictions piled on as Britain faced the blitz at home and the non-cooperation movement in India. In 1942, the colonial government began a massive expansion of the state regulating every aspect of life through war controls, requisitioning and expropriating property towards the war effort, military recruitment, diverting resources, rationing, currency controls, censorship, detention, and so on. Mass detentions following protests in 1942 eliminated much of the resistance to the imposition of such extensive controls.

After the end of WWII, and the announcement of Indian independence, the transitional government continued most of these regulatory controls on the economy. The new provisional government led by Nehru was focused on directing the economy through a central plan, and the extensive set of war controls came in handy. The administrative system in the Government of India Act, 1935, was adopted in large parts in the new constitution, and new price controls were added to the war controls. To govern with socialist goals, a lot of the economic controls necessitated exceptions. The British Raj was replaced by what C Rajagopalachari called the “license-permit-quota raj”—an elaborate system of controls to regulate private businesses, allocate most commodities, and dictate most aspects of everyday economic life. Soon after, criminal penalties were added for non-compliance for several “economic crimes” further increasing the complexity of the system. For instance, an early post-independence 1948 case, chronicled by De (2018), of the Baglas charged with committing offenses under the Essential Supplies Act, 1946 and for violating the Cotton Textile Order of 1948 when they were found in possession of 493 pounds of cotton cloth. The crime was transporting cotton without a valid permit (p.77). In the fifties and sixties, combined with the ideology of import substitution and protectionism, an elaborate system of industrial licensing accompanied war controls and commodity controls, often enforced using criminal penalties.

In their critique of industrial licensing, Bhagwati and Desai (1970) argued that “Indian economic policy suffered from a paradox of inadequate *and* excessive attention to detail” (p.5, emphasis in original). The immense complexity in the licensing system enforced in minute detail was simultaneously accompanied by glaring omissions in planning for essential public goods and infrastructure required for the same industries.

The system of economic controls was put in place to replace market allocation through political allocation. This, once again, led to a system that relied on personal social relationships, because personal networks determined access to licenses, industries, capital, and inputs. The original design of the Union of India tasked with central planning also created a system of dysfunctional federalism (Choutagunta et al., 2021), which hindered development of decentralized government. And finally, the process of implementing central planning also routinely ran into problems with constitutional rules, especially fundamental rights guaranteed by the constitution—like property rights, protection against state expropriation, and equality under the law. Rajagopalan (2015) argues that the formal institutions of socialist planning were

fundamentally incompatible with the constraints imposed by the Indian Constitution. This incompatibility led to frequent amendments to the Constitution, especially Fundamental Rights. Consequently, pursuit of socialist policies gradually undermined the Constitution. The contradictory mixture of socialism and constitutionalism led to economic and political deprivations that were never intended by the framers. And constitutional provisions like the Ninth Schedule of the Indian constitution provided further opportunity for rent seeking and exceptions (Rajagopalan, 2021), making India's regulatory structure as well as constitutional enforcement more complex.

India inherited at the time of independence a complex constitutional framework, economic system, and rules which combined with underlying fractionalization made it almost impossible to navigate and operate without the personal lives, privileges and inequalities that characterize a limited order.

5.2 Importing complexity: isomorphic mimicry and premature imitation

Complex regulation in developing countries is a consequence of both push and pull forces. The push is the “exporting of rules” where global aid and governance institutions like the World Bank, United Nations, and more specific international agencies dealing with the environment, wildlife, women and children etc. preach the desirable, though complex rules and regulations, from developed nations with strong state capacity where these rules are successful, to other countries with entirely different contexts. There are rules evangelists at these major agencies, who take it upon themselves to proselytize the regulatory framework across the world, irrespective of context or capacity. To satisfy external actors, weak states which are also usually recipients of foreign funding often prematurely imitate the complex regulatory systems of the donor countries. Even if aid is not linked to rules, there is a tendency to push for “best practices” to be adopted by developing countries, because of the misconception that the poor outcomes are linked to lack of regulation, and not linked to problems of governance capabilities. Examples include wildlife protection bureaus and anticorruption bureaus.

To satisfy external actors and states, organizations in the developing world mimic the rules and organizational forms of developed states, engaging in what Pritchett (2011) dubs ‘isomorphic mimicry’. He takes this phrase from evolutionary theory (that animals sometimes use deception to look more dangerous than they are to enhance survival) via the sociology of organizations to fragile states. Pritchett argues that is much easier to create an organization that looks like a police force—with all the *de jure* forms organizational charts, ranks, uniforms, buildings, weapons—than it is to create an organization with the *de facto* function of enforcing the law. The danger of isomorphic mimicry is that it creates a powerful dynamic in which what survive are not functional organizations and institutions, but mimics, which can adopt the camouflage of capable organizations without any of the associated drive for performance. The result is Potemkin organizations that *look like* they follow the rules and structure of organizations in more developed nations but actually operate in very different ways that are not just worse than those in developed countries but worse than they would have been without the investment in mimicry.

Equally, there are pull forces at play. The second way by which regulation from developed countries makes it way to the rest of the world is elite imitation. Rajagopalan and Tabarrok (2019) argue that elites in developing countries (in their study in India) often live at a standard of living comparable to that in developed countries and participate in cultural and intellectual conversations in the United States, Britain, and Europe. These elites' education, worldview, and international orientation have important consequences for policy decisions. Imported experts may mimic the policy debates and issues that belong to a different environment, usually one with higher state capacity. The most uncharitable interpretation is that the ruling elite make rules that benefit them, as, for example, maternity laws and labor protection that apply in practice only to elites in large, formal and often multinational organizations and firms. But the reason for the majority of the complex regulation imported from developing states may have more to do with elite thinking, beliefs and concerns—in politics, bureaucracies, universities, think tanks, foundations, etc.—that is more closely connected with Anglo-American elite thinking, beliefs and concerns than to the thinking, beliefs and concerns of the Indian populace. It's notable, for example, how much Indian elite concern there is over issues such as single use plastic straws and demands to replace it with paper straws. More seriously, labor protection, environmental protection, financial regulation, housing regulation, anti-corruption bureaus, wildlife protection agencies, etc., are all proliferating across the developing world, even in weak states, that do not have the capability to execute complex regulation.

For instance, as signatories to the International Labor Organization conventions, many developing countries have labor regulation that is so complex and myriad, it probably rivals the “good” rules of the developed world. India, which is unable to register births, or provide clean drinking water, sewage systems, and law and order to its citizens, nevertheless has one of the highest protections for labor, applicable to a fraction of its labor force (Joshi, 2017). For the last seven decades, the Indian Parliament has passed over 40 different statutes governing employer-labor relations.⁴

⁴ The Minimum Wages Act, 1948; The Payment of Wages Act, 1936; The Payment of Bonus Act, 1965; The Equal Remuneration Act, 1976; The Trade Unions Act, 1926; The Industrial Employment (Standing Orders) Act, 1946; The Industrial Disputes Act, 1947; The Weekly Holidays Act, 1942; The Factories Act, 1948; The Plantation Labour Act, 1951; The Mines Act, 1952; The Building and Other Construction Workers' (Regulation of Employment and Conditions of Service) Act, 1996; The Motor Transport Workers Act, 1961; The Beedi and Cigar Workers (Conditions of Employment) Act, 1966; The Contract Labour (Regulation and Abolition) Act, 1970; The Bonded Labour System (Abolition) Act, 1976; The Sales Promotion Employees (Conditions of Service) Act, 1976; The Inter-State Migrant Workmen (Regulation of Employment and Conditions of Service) Act, 1979; The Cine Workers and Cinema Theatre Workers (Regulation of Employment) Act, 1981; The Dock Workers (Safety, Health and Welfare) Act, 1986; The Child Labour (Prohibition and Regulation) Act, 1986; The Working Journalists and Other Newspapers Employees (Conditions of Service) and Miscellaneous Provisions Act, 1955; The Working Journalists (Fixation of rates of Wages) Act, 1958; The Employees' Compensation Act, 1923; The Employees' Provident Funds and Miscellaneous Provisions Act, 1952; The Employees' State Insurance Act, 1948; The Maternity Benefit Act, 1961; The Payment of Gratuity Act, 1972; The Unorganized Workers' Social Security Act, 2008; The Building and Other Construction Workers Cess Act, 1996; The Mica Mines Labour Welfare Fund Act, 1946; The Cine Workers Welfare (Cess) Act, 1981; The Cine Workers Welfare Fund Act, 198; The Limestone and Dolomite Mines Labour Welfare Fund Act, 1972; The Iron Ore Mines, Manganese Ore Mines and Chrome Ore Mines Labour Welfare (Cess) Act, 1976; The Iron Ore Mines, Manganese Ore Mines and Chrome Ore Mines Labor Welfare Fund Act, 1976; The Beedi Workers Welfare Cess Act, 1976; The Beedi Workers Welfare Fund Act, 1976; The Labour Laws (Exemption from Furnishing Returns and Maintaining Registers by Certain Establishments) Act, 1988;

Each state has additional protections through state level statutes, as well as several amendments to the federal level statute.

The goal of most of this regulation is to ensure that labor is treated “fairly” and to ensure that workplace safety, wages, etc. meet global standards while exploitation of labor is eliminated. India’s maternity regulation, for example, requires that firms of ten or more workers provide women with twenty-six weeks of paid maternity leave, up from the twelve weeks mandated earlier. India now requires firms to pay for more weeks of maternity leave than the United States or France. In fact, only Canada and Norway—with a gross domestic product (GDP) per capita that is twenty-seven and forty-seven times higher, respectively, than India’s—have longer required paid maternity leaves. Overall, India has a few hundred labor related statutes at the federal and state levels, and no one, perhaps not even government officials responsible for enforcing them, are aware of all the details. For instance, to implement the Minimum Wages Act, 1948, (and the future Wage Code 2020), roughly 3171 inspectors were expected to cover an estimated 7.7 million establishments i.e. 2428 establishments per inspector (data for 2012 released by the labor bureau). At two labor inspections a day, each establishment would be inspected once every five years. Overall, Despite being an ILO signatory and having one of the most elaborate labor protections in the world (see footnote), India is far from the ILO-prescribed labor inspector-working population benchmark ratio of 1:40,000 for underdeveloped countries but in India the ratio is 1:120,000.

The consequence of India’s labor regulation, however, is not generous maternity leave, high pay and good working conditions but rather one of the largest informal work sectors in the world. Over 80 percent of the working population in India is employed in the “informal” sector i.e. the firms that operate without the requisite licenses and inspections and violate most, if not all, labor regulation. This is possible by creating informal contracts, through middlemen, to avoid and evade the labor regulation, as well as bribing factory inspectors etc. And about 50–60 percent of India’s GDP comes from the informal sector.

Pushing firms into the informal sector has unintended consequences and dead-weight losses. Informal firms find it much harder to raise financial capital, attract the best human capital, and are vulnerable to arbitrary government action and closure. But the biggest opportunity lost in remaining informal is that these firms cannot achieve scale and must remain small. So, firms never grow to enjoy the economies of scale to compete nationally or globally.

The disconnect between law and practice is not unique to India. To give just one example, Uganda has had its anti-corruption laws rated 99/100—on paper Uganda is the best anti-corruption country in the world. Yet Uganda is also rated as having the largest gap between law and practice and is regularly beset by corruption scandals (Andrews et al., 2017, p.30).

Footnote 4 (continued)

The Employment Exchange (Compulsory Notification of Vacancies) Act, 1959. In a recent attempt to streamline labor laws the Indian Parliament consolidated 29 labor statutes into 4 labor codes, but keeping the content largely the same.

Both India and Uganda have complex regulatory system that, on paper, will rival the complex regulatory system of the United States. However, if the capabilities are compared, then India and Uganda are far behind, not only to present day United States, but also the past. Andrews et al. (2017, p.58) calculate and compare the revenues of India and Uganda in 2006 to revenues of United States in 1902 (all in 2006 dollars). Government revenue in India per capita in 2006 was \$102 and in Uganda was \$120. But in 1902, the government revenue per capita in the United States was \$526! But India and Uganda are not attempting to follow the regulatory system of the United States of 1902, which would still be hard given the gap in fiscal capability, but the complex regulatory system of present-day United States!

5.3 Endogenous complexity and enforcement swamping

Weak state capacity can lead to a high-corruption equilibrium. India's strong labor regulations, for example, are inconsistent with its economic reality and create a demand for corruption which India's weak state supplies. In a world where all of India's 40 federal labor statutes and hundreds of state level statutes were fully enforced, the private cost of compliance would be extremely high. And private actors may want to avoid or evade those costs. This is also true for a country like the United States but the United States can both better afford its regulations and better enforce them. Consider the payment and monitoring of various "inspectors". In the United States the chances of getting caught giving and taking a bribe are high, with a high chance of punishment. Moreover, in the US inspectors can be paid a relatively high "efficiency wage", making bribes less attractive. Knowing that inspectors are less likely to take bribes means that firms are less likely to offer bribes which in turn makes it less likely for inspectors to accept bribes even when offered. The resulting package tends to result in a low corruption equilibrium.

However, in a country like India, the circumstances are different. First, the private costs of compliance for firms are relatively high and therefore the incentive to bribe labor inspectors is fairly high. Second, India has far fewer "inspectors" per-capita than the United States (e.g. police, judges etc.) and they are not generally paid high wages. As a result, firms are more willing to offer bribes and inspectors are more willing to take them. A secondary effect is that as the number of bribes increase, because of enforcement swamping (Kleiman, 1993; Tabarrok, 1997), the chances of getting caught taking or giving a bribe decreases. Bribes to over-look bribe taking are themselves not uncommon. The system resolves into a high-corruption equilibrium. A recent survey, for example, found that bribing officials in India was considered "part and parcel of daily life" with 50 percent of Indians reported paying a bribe in the last year (Yeung, 2019).

In an equilibrium with high corruption, the public costs of enforcement increase. There are two elements to the costs of public enforcement. First as the complexity of the regulatory system increases, ideally the state needs to spend more to enforce complex rules. However, if state capacity does not increase, the opportunity cost of enforcing labor inspections increases as it means not enforcing health inspections, or providing clean water, or murder investigations. For a given, weak, state capacity,

each additional regulation or complexity in regulation increases the opportunity cost of enforcing existing regulation. In the Indian case, more onerous labor regulation clogging the system, pending in court, filing appeals means less attention on other crimes.

The unevenness of development aggravates the problem of subversion and corruption. As Henry Adams (1887) said about growing corruption in the United States:

“[A] weak government placed in the midst of a society controlled by the commercial spirit will quickly become a corrupt government.” Adams (1887)

India, for example, must deal with some firms that are as large as those in the United States but it must do with far lower state revenues or capacity. The influence of “big business” on government policy in the United States is widely decried. But how well would antitrust policy in the United States work if the government budget were 1/20th its current level, as India’s budget is relative to the United States?

Perhaps surprisingly, the optimal response to problems of subversion and corruption in a weak state is less regulation. Glaeser and Shleifer (2003) offer a model and conclude:

“In situations of extreme vulnerability to influence, corruption or intimidation, appropriate institutions might involve no legal or regulatory restrictions at all, as the alternative is a socially costly regime in which law enforcement is simply subverted.” (2003, p.404)

To try to break out of the high-corruption equilibrium, legislators often demand higher punishments which increase complexity, especially if the state has some commitments to fairness and justice. Citizens, NGOs, legislators, and even judges, routinely demand stricter criminal sentences to failing to obey regulations. The hope is that the severity of the punishment can make up for the low probability of punishment due to weak enforcement caused by capacity constraints (Becker, 1968). This is true for India where most regulation carries a criminal penalty for violation. For instance, in India, if employers violate the Maternity Benefits Act, 1961, or obstruct the work of the labor inspector, they can be punished with imprisonment of up to three months. This is not the exception but the rule. In the state of Delhi, to protect the environment, individuals and municipal agencies need to seek permission of the state forest department for cutting or pruning trees in their areas. And failure to acquire permission before cutting a tree carries a penalty of up to one-year imprisonment under the Delhi Preservation of Trees Act, 1994.

The high-penalty equilibrium, however, runs into India’s commitment to the rule of law, democracy and fair procedure. All Indian trains have an emergency stop button/chain. Often people misuse the emergency stop provision, or may play a prank, or delay an entire train and inconvenience thousands of passengers. So, there are rules against emergency stops, with a monetary fine and punishment with imprisonment of up to three months, with train inspectors to enforce these rules. But Indian Railways, like every other institution in India, has too few inspectors. So, there are too many “illegal” emergency stops, and often the criminal penalty is invoked. In

March of 1997 two major movie stars in India, Sunny Deol and Karisma Kapoor, were accused of violating Sect. 141 of the Indian Railways Act, 1989, and making an illegal emergency stop and delaying the train by 25 min. The criminal case went on for 22 years at the trial court until they were acquitted in 2019 (Criminal Revision No.1379 of 2019).

An absurd case of food adulteration took 38 years to resolve on appeal all the way to the Supreme Court of India (*Prem Chand v State of Haryana* Criminal Appeal No. 2255 of 2010). On 18 August 1982, the state food inspector, upon testing, allegedly found four living meal worms and two live weevils in a sample of *haldi* (turmeric) powder taken from Prem Chand's shop. He was charged under the Food Adulteration Act, 1954, for selling adulterated turmeric powder, and for selling without a license, punishable with imprisonment for 1–6 years and a monetary fine. The case went through a trial court, which acquitted Prem Chand after 13 years on 31 August 1995. Inexplicably, the State of Haryana appealed this decision. The High Court took another 14 years to rule, and, reversing the trial court's decision, convicted Prem Chand on 12 September 2009. Prem Chand appealed the High Court's decision, and after almost a decade, on 30 July 2020, the Supreme Court acquitted him. It found the procedure followed for testing impeachable—there is no receipt for the sample sent for testing the next day, and no evidence that it was not tampered with during the 18-day delay in report submission by the office of the public analyst. Enforcing food adulteration with criminal penalties stuck in the judicial system for almost four decades is not atypical for India.

Enforcement swamping also increases the error rate, mostly caused by the pendency of the judicial system. Indian courts have a backlog of cases that will take decades to resolve, meanwhile a lot of disenfranchised Indians are in jail, waiting to face trial. According to National Judicial Data Grid over 3.7 million (around 10 percent of the cases) have remained pending for over a decade before high courts and district/trial courts across India. Over 660,000 cases have remained pending for over two decades; and 131,000 for more than three decades (Krishnan, 2020).

In one sense, these extended cases are a failure but in another they represent two opposing but legitimate and indeed creditable forces. The failure of the state to prevent private predation increases the demand for punishment. But the consequence of such demands is a low-capacity prone-to-error state with enormous power to imprison almost anyone. The demand for rules, formalities, and checks and balances, which slow the punishment process, is a natural response to imbuing a low-capacity state with power it cannot exercise responsibly. Similarly, the enormous power of the state in the high-punishment equilibrium, motivates bribery and corruption both to escape and even worse to control punishment. Paradoxically the solution may involve reducing punishment. A motorist caught speeding is far less likely to pay a bribe when the fine was 400 rupees than when 2000 rupees, the new and increased penalty for speeding. It could even be the case that a paid fine of 400 rupees reduces speeding more than a 200-rupee bribe on a 2000 rupee fine.

5.4 The consequences of complex rules in India

Many of the problems of complex rules in strong states are amplified in weak states. In addition to the costs of complexity for private compliance and public enforcement, weak states face additional costs in error, corruption and exit. Given weak state capacity, for example, there is a higher chance of error in enforcing complex rules. And error costs can be disproportionately high i.e. if there are 10 percent fewer inspectors doing inspections that does not mean there is only a 10 percent error rate. Depending on the complexity of the tasks, the error rate can be high and consequential. As more regulations come with criminal penalties, for example, the number of false negatives in Indian's weak judicial system keeps increasing. India's commitment to the rule of law and fair process means that that at least some people, notably the privileged, can fight errors but the necessity of fixing errors just adds to the overburdened system thereby causing further errors. In an old but famous I Love Lucy scene, Lucy must wrap every candy on a conveyor belt without error. All is going well until one error cascades and Lucy becomes quickly overwhelmed.⁵

Weak states and complex rules are also breeding grounds for corruption. Corruption is easier to hide in weak states where inspectors are few and thus overburdened and error prone. The demand for corruption is also higher when complex rules impose relatively high burdens on a less wealthy and capable private sector and the supply is greater because inspectors and regulators aren't paid efficiency wages. Corruption becomes self-fulfilling and self-supporting.

More generally, Andrews et al. (2017) argue that the gap between the capability required to implement the complex regulation/best practices and the maximum achievable implementation at given levels of state capability, imposes significant stress on the system. And this stress pushes these developing countries into a path of even lower state capability under stress. In other words, prematurely loading given state capacity with complex rules adopted by developed countries can have very poor consequences on the ability of weak states to develop greater state capacity (Rajagopalan & Tabarrok, 2019).

Countries with weak states and complex rules also face the prospects of exit or near exit. Most firms in India, for example, operate in the informal economy where rules are often ignored. In the limit, some geographies may simply become ungovernable. Exit has its own costs. The underground economy must stay underground.

Finally, there is a big impact on economic growth. The greatest potential casualty of complexity prematurely loaded on weak state capacity is thus a world where there is insecurity of property rights as the state cannot enforce basic rules to protect property from theft, externalities, and fraud. Simultaneously, weak states also do not control their agents effectively, making the possibilities of public predation, like bribes, expropriation, etc. much higher. And both private and public predation hamper economic growth.

⁵ The scene can be found <https://www.youtube.com/watch?v=HnbNcQlzV-4>.

6 Conclusion

Simple rules for a complex world argued the need to consider the tradeoff between the kinds of social incentives imposed by complex rules against the costs of public enforcement and private compliance imposed by these rules. Of course, the ability of a complex rule to bring about the socially desirable individual behavior depends on enforcement of those rules.

Given the inability to enforce these complex rules, states with limited capacity should rely more on markets even when markets are imperfect—presumptive laissez-faire. Rajagopalan and Tabarrok (2019) argue that the market test isn't perfect, but it is a test. Markets are the most salient alternative to state action, so when the cost of state action increases, markets should be used more often.

In these conditions, the Epsteinian presumption towards simple rules and towards laissez-faire is the optimal form of government for states with limited capacity and also the optimal learning environment for states to grow capacity. Under laissez-faire, wealth, education, trade, and trust can grow, which in turn will allow for greater complexity of regulation, if desirable, in the future. This is the trajectory of almost all developed countries, who had a long period of laissez-faire and simple rules governing the market system, until they got rich enough to develop the capacity to enforce complex rules.

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