Chapter 4
Towards elite agency constrained and enabled by power and institutions

> Another moral is that macroeconomics, like microeconomics, must go beyond Keynesian and monetarist formulas and analyze the structure of the incentives [. . .] Macroeconomic evils, like other social and economic phenomena, would not persist unless they brought gains to some. (Olson, 1984, p. 644)

This cross-disciplinary chapter on institutions focuses on the incentive system and takes specific positions in relation to the literature. For instance, this inquiry concurs with North (1994, p. 364) when he states that: "Incentives embodied in belief systems as expressed in institutions determine economic performance through time," but adds an emphasis derived from the opening quote above: institutions express incentives yet these incentives—the relevant incremental change stored as institutional arrangements—are manifested in business models to a much greater degree than belief systems and the "cumulative experience of past generations that is embodied in culture".

Institutional change is understood as the adjustment of the incentive system. This chapter starts by reinforcing the conceptual scaffolding of elite agency in the political economy (4.1). The ideas reviewed from the literature on the political economy and studies of power in sociology coalesce into the new institutional economics framework in line with North's grand theorizing as outlined by Telles (2024), thereby further consolidating the notion that elites are the microfoundation of institutional formation and change and hence of incentive structures (4.2). The chapter closes with a critical examination of the relationship between elite power and leadership (4.3).

4.1 Conceptual elements for elite agency in the political economy

This brief introductory section reexamines the building blocks of elite agency with an emphasis on leadership (4.1.1), before pausing to revisit the conceptual elements from Chapter 3 that support theorizing on elites in the political economy (4.1.2). On these bases the inquiry proceeds to a theoretical discussion of the elite as the agency that moves and advances all that is relevant in society.

https://doi.org/10.1515/9783110734638-007

4.1.1 Elite agency as leadership

> This difficulty in identifying individual leader effects should prompt policy makers and commentators alike to be cautious when opining that particular leaders are good or bad for growth. (Easterly & Pennings, 2020, p. 6)

This work takes the position that the two fundamental varieties of business model leadership (see Figures 1.2, 2.1, and 4.1) are part and parcel of elite agency, and that additional transformational varieties (Table 7.2) are necessary for growth. Leadership is deployed in the service of the coalition's elite business model. Elite agency is understood to be the cardinal and most decisive type of agency in the political economy. Elite agency is 'what elites do' and is realized through leadership that succeeds at attaining and then maintaining elite status (through power) while maximizing the utility function of the coalition (through residual income, see Propositions 5 and 6). Elite leadership thus necessitates the articulation of visions in the three discrete contest arenas of the political economy to accumulate (bargaining) power and convert these power endowments into residual income gains. Effective leadership relies on 'political economy know-how' and 'knowledge' (see Figure 2.3). Leadership—"one of the most comprehensively researched social influence processes in the behavioral sciences"—is described in Parris and Peachey's literature review:

> the success of all economic, political, and organizational systems depends on the effective and efficient guidance of the leaders of these systems (Barrow, 1977). A critical factor to understanding the success of an organization, then, is to study its leaders. [. . .] Great leaders create a vision for an organization, articulate the vision to the followers, build a shared vision, craft a path to achieve the vision, and guide their organizations into new directions (Banutu-Gomez & Banutu-Gomez, 2007; Kotter, 2001). [. . .] Leadership theories attempt to explain and organize the complexity of the nature of leadership and its consequences (Bass & Bass, 2008). Over the years, some leadership scholars have called attention to the implicit connection between ethics and leadership. (Parris & Peachey, 2013, p. 377)

Elite leadership introduces the conceptual element of micro-level leadership into analysis of the political economy. Elite agency requires an understanding of the processes by which the proximate power accumulation objective fulfills the distal, ultimate objective of elites—the generation of sustainable residual income streams. The difference between elite and non-elite business model leadership is the degree to which the former succeeds in accumulating power and then utilizing the 'extraordinary lever' to interact with institutions in pursuit of institutional formation and change (see Figure 4.4). Effective elite agency is carried out at the elite business model level through the two discrete forms of elite leadership: elite coordination leadership, which requires 'political economy know-how', the objective of which is power (see Figure 1.2), and elite business model leadership, which requires 'knowledge', the objective of which is residual income (see Figure 2.1), ultimately accumulated into wealth. These two fundamental leadership varieties are depicted in Figure 4.1.

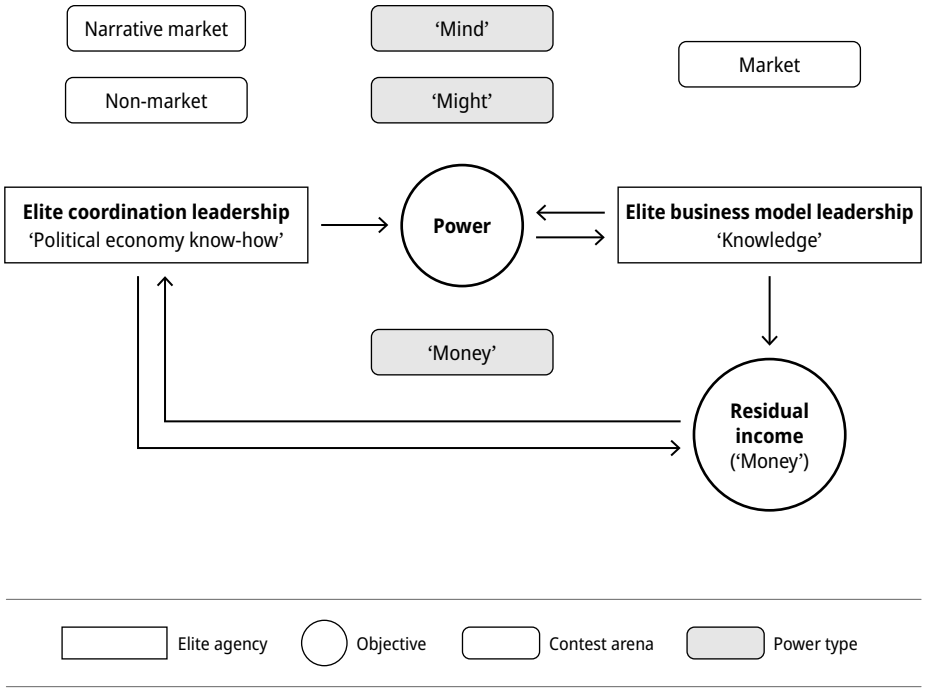

Figure 4.1: The two fundamental elite agency leadership varieties and their power and residual income objectives.

The study of elite business models necessarily brings the subjects of strategic management and leadership into contact with institutionalism. Elite coordination leadership accumulates power in the political economy (in the three contest arenas) to obtain a license to operate within the general institutional set up to legitimately scale power endowments and residual income flows. It is self-evident that elite business model leadership requires 'knowledge', exemplified in an array of management capabilities, as 'political economy know-how' alone is an insufficient condition to prevail in the market arena and effectively convert power into residual income.[61] The two-way conversion process between accumulated residual income (wealth) and power that is intrinsic to Figure 4.1 is a widely known and understood relationship (see the examples of oligarchs from El Salvador to South Africa detailed in Lingelbach and Rodríguez

61 An issue that is often overlooked by political elites at the center of elite coalitions is that the power types of 'might' and 'mind' alone do not guarantee sustainable residual income flows. The performance of Petróleos de Venezuela, S.A. (PDVSA) is an example of how powerful and institutionally privileged business models with ample 'political economy know-how' and bargaining power, but bereft of 'knowledge', can deteriorate into chronic underperformance, generating far less 'money' than it should given its munificent resources.

Guerra, 2023). Residual income generation at scale is a necessary but insufficient condition for economic development.

Transformational leadership, amply discussed later and essential to this work's normative positions (see Section 5.3, Table 7.2, Chapters 7 and 8), is leadership that is oriented towards implementing and incentivizing the higher sustainable value creation elite business models that lead to development. This is where leadership and the set of ethical principles of the ETED (see Chapter 8) explicitly connect and can inform social and political movements and initiatives (for further details on this logic see Figure A5.12a). Easterly (2011), Easterly and Pennings (2020), and other works that minimize the impact of leadership on the political economy, discount elite agency. Instead, this inquiry adheres to Brady and Spence's position that by "making basic choices and building consensus without which the economic dynamics cannot get off the ground", and by many other means, "leadership plays a role in generating sustained growth" (2010, p. 4). This aligns with 'the great elite coalition for development' conjecture, derived from Carlyle's (1840/2008) Great Man Theory of history (Section 1.3.3), where the leadership choices of eminent individual elites drive human and economic development (see the reflections on elite judgment that close this book in Chapter 8). It is also consistent with "a micro-level approach to understand what drives successful change", connecting "sustainability change agents" with business leadership and asking: "how, then, do we create heroic leaders?" (Walls, Salaiz, & Chiu, 2021, pp. 499, 503).

4.1.2 Central conceptual elements for a theory of elites

> From Adam Smith's *Wealth of Nations* in 1776 (or perhaps the Physiocrats even earlier) until at least John Stuart Mill's *Principles of Political Economy* in 1848, what we now call "economics" was in fact generally referred to as "political economy". (Drazen, 2000, p. 3)

There was an early awareness that the economy does not operate on the logic of mechanistic equilibrium but on the rules of a distributional game. This is in accordance with today's generally accepted understanding of the political economy: "The study of production and trade and their relations with law, custom and government; and with the distribution of national income and wealth".[62] This definition, on the website of the Department of Economics at Harvard University, references "law, custom, and government", i.e., institutions, while "production and trade" points to value creation and the "distribution of national income and wealth" to the value transfers that ultimately result in the economic winners and losers (see Proposition 13 on elite agency performance). Ultimately, analysis of the political economy in this inquiry is analysis of the value creation and extractive value transfer possibilities and actualities (transfer-IN/OUT) enabled by a society's business model rules. The sustainable

62 See: https://economics.harvard.edu

value creation (SVC) framework elucidates the long-term development trajectories of nations, a subject which becomes especially gripping in comparative terms: for example, refer to the divergent paths between the UK and Germany from the second half of the 19th century until 1945 (see Ricardo, 1817/1999; Gerschenkron, 1943/1966); the US or Argentina in the early 20th century; or China and India in the late 20th century and early 21st. Any appraisal of a country's future cannot overlook political economy distributional outcomes in the elite agency microfoundations of institutional change model (see Figure 3.3), the mechanisms by which winning elites win and losers lose, the quantities of transfers and the ensuing sustainable value creation of winning elite business models, how these agglomerate at the meso-level of the elite system and are reflected in elite quality, and consequently impact the economy and development.

Analyses based on the sustainable value creation and value and risk transfers (i.e., rent seeking) of specific elite business models are marginal to mainstream economic theory (as in the neoclassical syntheses of Hicks, 1937; Samuelson, 1947), seldom find application in policymaking, and are often also missing from public discussion forums unless, like inflation, war, or gun rights, they have major social effects. Even then, the models and debates are not framed in terms of value creation or quantified with measurements (like the VCr, through the use of precise extractive/inclusive transfer-IN/OUT SVC metrics). For instance, whether one examines the public discourse on the low interest rates introduced after the 2008 Great Recession or the COVID-19 fiscal support packages, the link between micro-level elite coalition business models enabled by the politics of institutional and policy changes and the aggregate value creation capacity of the elite system and society as a whole is rarely considered systematically, even when there is abundant relevant knowledge (see, for instance, the analysis of political economy responses to the recent pandemic by Coyne, Duncan, and Hall, 2021).

Key conceptual elements developed in the inquiry to address this gap are presented in Table 4.1. They provide a basis for an elite-based analysis of the political economy and institutional change and are the conceptual building blocks for the ETED. Elite agency is the central behavioral force in the political economy, the decisive micro-driver of macroeconomic development trajectories. The elite system is made up of elite coalitions in competition and subject to the checks and balances of their competitors as they procure institutional change consistent with their business model preferences. Through lower transaction costs and higher levels of trust, elites are more effective at collective action and so accumulate power (elite coordination leadership). Then, the capable hands of leaders, often managing 'knowledge', convert (bargaining) power into residual income (elite business model leadership). The critical issue for society and the economy essentially becomes one of transformational leadership: do elites increasingly generate their residual income through value creation or extractive value transfers and, if the latter seem to be more typical than the former, how can leaders transition their business models to higher levels of sustainable value creation?

The elite system, made up of a nation's elite business models, is the meso-level construct that integrates all value and risk creation and extractive value transfers. Elite quality is the aggregate emergent conceptual element that characterizes the functioning of the elite system as the transition mechanism between firms at the micro-level and macro-level economic outcomes. Conceptually, it is a description of 'GDP origination', the proportion of national income that emanates from first-order productive value creation activities vs second-order value transfer activities. The corollary is that the degree of sustainable value creation of elites in particular (measured by SVC measurements like the VCr) jointly adds up to the overall wealth of a nation. It is normatively consequential to incentivize those *qui generat valorem* ('who create value'). Foundational conceptual elements related to the ETED view of the political economy, along with the respective levels of analysis, are presented in Table 4.1.

Table 4.1: Definitions of key ETED conceptual elements and the analysis level used.

Analysis level	Conceptual element (Section reference)	Definition
Micro	Elite business model (Section 2.2.1, Proposition 7)	Elite business models are the largest residual income and reward business models in the economy and constitute a system of interdependent activities that are performed by a particular principal, as part of an elite coalition, in relation to its stakeholders. An elite business model describes *how* the principal and the stakeholders respectively create and appropriate value through division of value strategies to generate proprietary residual income, and associates with discrete sustainable value creation.
Micro	Elite (Section 1.2.4)	An elite is a coalition operating society's leading value creation and appropriation business models that generate the largest quantities of economic activity and residual income. Organizationally, and thus for analytical purposes, an elite is a business model that a coalition has secured from institutions—through wins in the political economy's market, non-market, and narrative market arenas—with limited rights that afford value appropriation advantages and, in consequence, a license to operate at a discrete sustainable value creation position.
Micro	Elite agency (Section 1.2.4)	Elite agency is 'what elites do' in relation to their elite business model as principals in a coalition (of economic, political, and knowledge interests) that creates value jointly with stakeholders in formal and informal exchange relationships, exercising leadership to successfully leverage lower transaction costs, higher levels of trust, and superior coordination capacity into (bargaining) power that is then converted into society's largest streams of residual income via first-order value creation or second-order value transfers.

Table 4.1 (continued)

Analysis level	Conceptual element (Section reference)	Definition
Micro	Value (Section 2.2.2, Proposition 8)	Value is everything that humans determine is worth appropriating. The creation of value is via first-order productive activities.[63]
Meso	Elite system (Section 3.2.3, Proposition 17)	The elite system is a meso-level generic structure constituted by elite coalitions and characterized by their business models. It is a high-impact sub-system of the macro-level economic system whose emerging properties play an outsized role in a nation's economic development.
Meso	Elite quality (Chapters 4, 5 and 6)	Elite quality is the meso-level emergent property of the elite system that describes the relative proportion of first-order productive value creation and second-order extractive value transfers of all elite business models in a political economy. This sustainable value creation aggregate has a purported independent variable relationship with human development and economic growth. A comparative global measurement of elite quality is the Elite Quality Index (EQx).
Micro, meso, macro	Sustainable value creation (Section 2.3.2, Proposition 11, see Table 2.3)	A conception of sustainability based on the business model where value is appropriated from first-order activities rather than transferred from the first-order value creation activities of third parties. Value is everything that humans determine is worth appropriating and business models based on 'value appropriated but *not* created' are non-sustainable. The relative proportion between first-order value creation and second-order value transfers at the business model level is operationalized by measurements such as the Value Creation Rating (VCr) and Value Creation Position (VCp).

The first two entries in Table 4.1 are 'elite business model' and 'elite'. While the distinction between the two conceptual elements has already been made (see Section 2.2),

63 Value can be understood in alternative terms, for instance, by using an analogy to the second law of thermodynamics with its focus on energy and its dispersion (positive entropy occurs in an isolated system as energy naturally disperses). In a socio-economic system, value is consumed or decays, becoming increasingly obsolete to humans, and so also tending to disperse (i.e., there is nothing of value worth appropriating) unless new value is created. The creation of value is therefore the human agentic mechanism by which entropy is locally reduced in the human domain (i.e., value that is worth appropriating expands). In contrast, the friction and inhibiting ramifications of second-order transfers of value locally hasten the increase of entropy. That is, elements that would otherwise be arranged in valuable configurations become disordered. The zone of the social habitat where the value creation vital to economic development—the high order (negative entropy)—that human beings require to advance and flourish occurs is the elite system of the political economy. See also footnote 169 and Sections 7.2.3, 8.1.6, and 8.3.3.

it is now further detailed with reference to social network theory, its structuralist perspective, and the notion of elite agency (Section 1.3). Social networks are defined in Mitchell as "a specific set of linkages among a defined set of persons, with the additional property that the characteristics of these linkages as a whole may be used to interpret the social behavior of the persons involved" (1969, p. 2, as cited in Tichy, Tushman, & Fombrun, 1979, p. 507).

Based on the above understanding, social network analysis (SNA) emerges as a method "to identify central individuals and key decision-makers" (Kostiuchenko, 2011, p. 195). Scott stresses SNA's "origins in classical sociology and its more recent formulation in social scientific and mathematical work" (1988, p. 127), while Mizruchi (1994 p. 339) emphasizes that "not only can network analysis be employed in conjunction with institutional theory but it is compatible with and capable of extending the population ecology and transaction cost models as well" which is consistent with the embeddedness of Granovetter (1985) and its focus on the transaction. Since the "social network provides a powerful model for social structure" it is employed in a variety of fields such as "studies of kinship structure, social mobility, science citations, contacts among members of deviant groups, corporate power, international trade exploitation, class structure, and many other areas" (Scott, 1988, p. 127). Past reviews noted that "network analysis represents an underutilized framework for analyzing and conceptualizing organizations" (Tichy, Tushman, & Fombrun, 1979, p. 516), while Coles (2001) chided criminologists for not using SNA to study organized crime. Today, the approach unlocks the boundless possibilities of data, not only in criminology but in fields such as risk management, innovation management, or knowledge management, where studies showcase the extent and "practical use of SNA in business and management research" (Anugerah, Muttaqin, & Trinarningsih, 2022, p. 1). By capitalizing on the embeddedness notion of Granovetter (1985), SNA even reveals performance where, for instance, "individuals' positions within social networks confer advantages" in the organization (Sparrowe, Liden, Wayne, & Kraimer, 2001, p. 316). At the political economy level, SNA elucidates "the interlocking ties of corporations and states" (Wellman, 1983, p. 179), or "the structure of an elite network in major American institutions" (Moore, 1979, p. 689). This method primarily identifies elite individuals, which seems vital "when interest groups and friendship networks become the basis for the creation of an internally circulating 'ruling class' whose members periodically seize key positions in different institutions and collectively capture the decision-making process at the state level" as Kostiuchenko analyzed for Ukraine (2011, pp. 195–196). Yet while the chief analytical focus of SNA is on individuals, this inquiry positions the elite business model—with its value and financial flows across stakeholder relationships—as the central conceptual element.

Social network analysis is relevant to the ETED insofar as it elucidates principal-stakeholder relationships that have residual income implications across and within organizations, and is of particular interest in instances when there is a lack of clarity (e.g., criminal organizations; the "secretive and stealthy" oligarchs of Lingelbach & Rodríguez

Guerra, 2024). However, simply determining an 'elite' within a network, whether using SNA or any other method, does not imply the identification of the elite business model or the individuals that will capture most of the value. Siegel (2009, p. 137) notes how "the impact of highly connected individuals" will be constrained by rivals in intra-elite contests and by the effectiveness of their agency (especially elite business model leadership, Figure 4.1), while the network position or the "number of connections", even when elites in the abstract are coordination capacity enabled by low transaction costs (Proposition 4, Section 1.3.4), does not reveal the business model, much less its all-important sustainable value creation. In this work, elites and the business model (with its certainly elite) beneficiaries are deliberately separated for the purpose of analysis, as the latter is relevant for development (see Table A4.2 for diverse perspectives on the 'elite' conceptual element) and is best ascertained with recourse to plain economic and financial analysis (see footnote 3). The social network diagram for the single individual (such as Musk or an autocrat in an emerging market) will commonly differ from that of the elite business model with its array of stakeholder relationships—the locus of elite agency—from which members of the elite coalition collect residual income.

To distinguish the basic conceptual elements of this theory a final point is needed. When individual elites are connected to their legacies, institutions are often portrayed as the most salient element. Thus, as Ralph Waldo Emerson writes:

> An institution is the lengthened shadow of one man; as Monachism, of the hermit Antony; the Reformation, of Luther; Quakerism, of Fox; Methodism, of Wesley; Abolition, of Clarkson. Scipio, Milton called "the height of Rome"; and all history resolves itself very easily into the biography of a few stout and earnest persons. (Emerson, 2005, para. 8)

Whether one considers the leadership of Scipio in the non-market arena or of Luther in the narrative market arena, the "lengthened shadow" that they cast are their business models; institutions, no matter how worthy and inclusive, are simply their instruments.

4.2 Elites as the microfoundations of institutional formation and change

The original use of the term "institutional economics", employed by Hamilton in "The Institutional Approach to Economic Theory" asserts that "economic theory should unify economic science" (1919, p. 312), and invites a holistic conceptualization of the economy (Rutherford, 2001) that is compatible with Parsons (1951/1991). This inquiry's system represents an effort in that direction, one that Fukuyama (2016, p. 213) would term an "attempt to return to macro theorizing" where the purpose is "to explain long-term institutional development in an integrative fashion". This holistic institutional perspective builds on Proposition 12 that posits elite agency as the chief microfoundation of institutional change.

In the initial sub-section, background research is presented to support the notion of institutions as the incentive structure that is at the root of residual income flows resulting from division of value strategies, and thus of variances in economic and development outcomes (4.2.1). The next sub-section presents the modest but pointed research on the causal relationship between elite agency and institutional variance (4.2.2). The elite agency microfoundations of institutional change model is updated with the specification that the institutional preferences of elites are for business model rules (Figure 4.2). This is followed by a review of elite embeddedness and the paradox of agency that is both constrained and enabled by institutional structures (4.2.3). The 'room' metaphor of Giddens (1984) is appropriated and adapted to explain institutional change driven by elite business models. Discrete elite conceptualizations of embeddedness for business model and intra-elite contest rules are respectively proposed and the relationship between the two is expounded on (see Figure 4.3). Finally, the early institutionalist debate around spontaneous and deliberate institutional formation and change is discussed to explain elites as the microfoundation of institutionalism and further bolster the bedrock for this work's grand macro theorizing (4.2.4).

4.2.1 Institutional theory links incentive structures with division of value strategies and economic outcomes

> In political bargaining over institutional change, the positions taken by individual parties are determined by their expected net gains from the new arrangement. Those net gains are a function of both the anticipated aggregate benefits from modifying [institutions such as] property rights and the associated share formula for distributing those benefits. (Libecap, 1989, p. 7)

From an economic development perspective, the decisive institutions are those that North (1991a, p. 97) notes determine "the profitability and feasibility of engaging in economic activity". That is, the rules that act as a *de facto* incentive structure and lead to action (Nee & Swedberg, 2008), or, in Baumol's celebrated phrase, provide "the reward structure in the economy" (1990, p. 894). Olson also makes the same connection in his journal article: "Microeconomic Incentives and Macroeconomic Decline" (1984). Economic rewards will accrue to those whose business models align with institutions. More precisely, these rewards—in the form of power and, ultimately, residual income—go to those who can effect institutional change, or "hack" institutions (see Schneier, 2023), i.e., in both cases adjust the incentive system in favor of their business models. Elite agency secures the preferred division of value strategies in the principal-stakeholder relationship to appropriate value created, as well as value *not* created (see the application of the VCA analytical framework at the firm level, Section 2.2.3). Power and residual income (or profits) are resources that in turn enable their beneficiaries to further advance institutional change for incentive system adjustments consistent with their business model preferences. The process has a circular quality (as depicted in Figure 4.1), since elite coordination leadership and elite business model leadership on the one hand, and their

outcomes (power and residual income) on the other, are mutually reinforcing. Power enables institutional change that in turn clears the path for more power and residual income accumulation (i.e., wealth) to facilitate further institutional change and incentive system adjustment (as is later depicted in Figure 4.4).

Veblen (1899/1924, 1904/1975), an early exponent of institutionalism, viewed institutions as "constraints" and "generally accepted ways of thinking and behaving" that were "due both to the inertia inherent in any established scheme and to the defensive activities of vested interests", all of which were deemed potentially problematic when these were "out of step with new technological means and with the economic issues and social problems they generated" (Rutherford, 2001, p. 174). In other words, the proto-institutionalism of Veblen already conceived of the links between elites (vested interests) and institutions and implied the existence of extraction (including by elites who fail to innovate by maintaining business models that do not keep up with progress). Another early institutionalist, Commons, shared the logic of elites effecting institutional change, pointing to "customary rules that are initially produced from below and later sanctioned from above" (Chavance, 2012, p. 33). Moreover, in *Legal Foundations of Capitalism* (1924), the approach of Commons "was built on his notions of the pervasiveness of distributional conflicts, of legislatures and courts as attempting to resolve conflicts (at least between those interest groups with representation), and of the evolution of the law as the outcome of these ongoing processes of conflict resolution" (Rutherford, 2001, p. 176). In short, an early theoretical foundation exists to support the idea that elite business model preferences and elite agency drive institutional change (as is reflected in the elite agency microfoundations of institutional change model, Figure 3.2) and, more specifically, the shaping of intra-elite contest rules.

Despite its promising progress in the interwar period, after 1945, institutional economics failed to advance out of the long shadow of neoclassical theory, was squarely outside of the mainstream, and was "banished to the ill-regarded discipline of sociology" (Rutherford, 2001, p. 186). Recovery came when variations of institutional theory leveraged some (not all) of the cardinal assumptions of neoclassical economics, including scarcity and competition: "Douglass North, along with Ronald Coase, Elinor Ostrom, and Oliver Williamson, transformed the early intuitions of new institutional economics into powerful conceptual and analytical tools that spawned a robust base of empirical research" (Ménard & Shirley, 2014, p. 3). Mainstream economic theory then "took over those aspects of institutionalism amenable to 'model analysis'" (Copeland, 1951, p. 59, as cited in Rutherford, 2001, p. 184), such as labor economics and industrial organization. Yet, as the re-born institutional approach managed to plug an important gap in neoclassical economics, it did not articulate a specific role for elites in its revamped discourse. Institutions, however, have entered the realm of development economics.

Hall and Jones (1999) argue that institutions (which they conceive of as social infrastructure) account for the differences in capital endowments and productivity and hence for long-term growth in line with research by Glaeser, La Porta, Lopez-de-Si-

lanes, and Shleifer (2004). Djankov, McLiesh, and Ramalho demonstrate how the World Bank's *Doing Business Report* database is a measure of institutional quality (understood as the "burden of business regulations") and hence "an important determinant of growth" (2006, p. 399). The literature on varieties of capitalism recognizes the relationships among institutions, politics, and the economy and the impact of those relationships on economic outcomes (Hall, 2015, p. 1). Acemoglu and Johnson (2005) unbundle institutions and identify those that have "a first order impact on long-run economic growth", i.e., the "property rights institutions" that "protect citizens against expropriation by the government and powerful elites", contrasting these with "contracting institutions" that are found to matter less (2005, p. 949). Rodrik, Subramanian, and Trebbi (2004), start their seminal paper, "Institutions Rule", by citing Smith's *Wealth of Nations* ("Commerce and manufactures, in short, can seldom flourish in any state in which there is not a certain degree of confidence in the justice of government") and go on to show how institutions are more relevant than geography or trade in determining income levels around the world. Robinson, in the spirit of Hamilton's "general concern" of economics (1919, p. 318), describes the centrality of institutions in terms of both incentives and the division of value:

> Economic institutions matter for economic growth because they shape the incentives of key economic actors in society, in particular, they influence investments in physical and human capital and technology, and the organization of production. Economic institutions not only determine the aggregate economic growth potential of the economy, but also the distribution of resources in the future. (Robinson, 2010, p. 3)

4.2.2 Elite business model variance drives institutional variance

> Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction. In consequence they structure incentives in human exchange, whether political, social, or economic. Institutional change shapes the way societies evolve through time and hence is the key to understanding historical change. (North, 1990, p. 3)

Rules exist as such, but they also manifest as "formal organizational structures [that] arise as reflections of rationalized institutional rules" (Meyer & Rowan, 1977, p. 340). The rules that organized entities like government bodies, political parties, law enforcement agencies, courts, central banks, stock exchanges, research institutes, educational institutions, churches, NGOs, museums, and sports federations put in place address specific functions in society. There is a consensus that institutions are a key determinant of economic outcomes and development.[64] Does it then matter how institutions—those "humanly devised constraints"—arise in the first place?

64 Institutions and policies are two constants of this work. Both conceptual elements overlap since, according to Khan (2018, p. 640), they "have an effect on economic, social or political outcomes" and

Hall and Jones (1999) argue that institutions are endogenously determined by history (they are even partially captured in language) while Greif and Laitin (2004) build on repeated game theory to offer a dynamic theory of endogenous institutional change and stability. Sachs (2003) or Easterly and Levine (2003) identify geography as a determinant factor while Rodrik, Subramanian and Trebbi (2004, p. 135) nuance its "significant effect on the quality of institutions". State capacity accounts for the quality of institutions in the work of Bourguignon and Verdier (2010) as well as in Acemoglu and Johnson (2005), Rodrik, Subramanian, and Trebbi (2004), and Zhang (2022). Alexander and Welzel affirm the scholarly consensus "that state failure in the enforcement of rule of law is the key factor separating effective from ineffective democracies" (2011, p. 271). Leaning on Proposition 12 ('Elite agency is the principal microfoundation of institutional change') and foundational to this inquiry are the works of Bourguignon and Verdier (2010, pp. 1, 2), who point to institutional change brought about by elites, as well as Acemoglu and Johnson (2005), Acemoglu and Robinson (2008), Brezis and Temin (2007), "The Elite as a Critical Factor in National Development", a case study on Botswana by Sebudubudu and Molutsi (2011), and especially Robinson (2010), and various contributions to Amsden, DiCaprio, and Robinson's *The Role of Elites in Economic Development* (2014). Khan (2018, p. 636) offers a coherent causality argument: "Institutions and policies describe rules that in turn determine resource allocation, and these can affect different types of organizations in very different ways. Organizations can be expected to support, resist or distort particular institutions or policies depending on their interests and capabilities."

To Robinson (2010, p. 3) "a crucial factor in explaining the persistence of institutions is how elites form around sets of institutions and how elites persist and reproduce over time". In this articulation, the direction of development is from institutions to elites, yet, at the same time, the elite agency of winning elites accounts for institutional persistence. For instance, one could consider the effects of French revolutionary reforms to abolish the seigneurial regime and establish free (labor) markets on the German guild system. The first takeaway from this example is that institutional differences lead to divergent economic outcomes. Specifically, the institutional differences associated with the application (or not) of the *Code Napoléon* resulted in dissimilar value creation incentives and hence divergent growth trajectories:

> Acemoglu, Cantoni, Johnson and Robinson (2009) show that parts of Europe that were reformed by the French between 1792 and 1815 experienced significantly more rapid economic growth and increases in urbanization in the 19th century compared to those parts which were not reformed. (Robinson, 2010, p. 17)

"change the distribution of benefits in society". Their distinction in this work follows his articulation: "Policies can be defined as rules that are generally easier to change than institutions".

A second and critical takeaway is that an accumulation of institutional change results from elite agency (or the lack thereof):

> After 1815 (Congress of Vienna), the reforms implemented by the French persisted in precisely those areas where old elites were unable to return. (Robinson, 2010, p. 17)

As previously stated, the ability of elites to apply their preferences on institutions—elite coordination leadership—rests on 'the extraordinary lever' of elite coalitions and their lower transaction costs and higher trust levels compared to distributed larger non-elite groups (see Proposition 4; Figure A5.3a). Power can be used for value extraction, as is illustrated by Acemoglu's (2006, p. 515) words: "elite preferences over inefficient policies translate into inefficient economic institutions". As stressed by Khan (2010, p. 25), "the 'rent-seeking' activities of powerful groups result in the creation of both formal and informal institutions". On the other hand (and consistent with elite business models as the locus of this theory), elites running business models with high levels of sustainable value creation (measured by VCp/VCr) lobby for efficient institutions and bring about higher degrees of long-term economic and human development. One might think of the factory business model of the industrial revolution that combined division of labor, sizable capital outlays, and management to cost-efficiently mass-manufacture standardized products. Elite institutional preferences emerge from elite business models with varying degrees of sustainable value creation and lead to inclusive/extractive institutions—in the terms of Acemoglu and Robinson (2013a)—through accumulated institutional change (which can also be imagined on an extractive to inclusive conceptual continuum that parallels the business model 'value spectrum' in Figure 2.10). Elite agency, actualized through effective elite coordination leadership and elite business model leadership, develops business models while advancing rules on taxation, subsidies, technology, trade, environment, safety, labor, intellectual property, privacy, transportation, data, consumer protection, energy, public health, zoning and land use, immigration, telecommunications, cybersecurity, securities markets, bankruptcy, etc. for their advantage. By promoting the optimal set of laws (binding statutes established by government bodies) and regulations (actionable and enforceable guidelines derived from laws and policy) as the rules for their business models in the political economy, elites become the determinant factor of institutional change and incentive setting (again, both inclusive and extractive). Figure 4.2 provides additional granularity to the elite agency microfoundations of institutional change model (Figure 3.2) by highlighting that the relationship between elites and institutions is anchored by the preferences that matter most to the residual income of elites—the business model rules.

Of all agents in the economy, it is the principals of elite business models that have the strongest motivation to amass and wield the full power of their agency to enable their preferences and remove institutional constraints. Elite coalitions reap the highest returns (or losses) from business model rules that align with (or deviate from) their business model logic and so have rather more at stake than broader or non-elite coalitions. These narrower coalitions have less dispersed interests that they are more

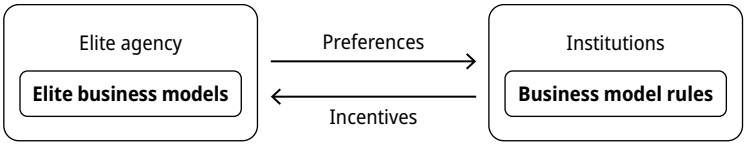

Figure 4.2: Elite institutional preferences as business model rules in the elite agency microfoundations of institutional change model.

adept at defending. Consistent with Proposition 18 ('Elites shape institutions primarily through intra-elite contests'), the major constraints for elites are not institutions (e.g., the returning old elites in Germany scrapped elements of the *Code Napoléon*), but rival elite coalitions (e.g., new elites in Germany that preserved the Napoleonic institutional change and encumbered the return of old elites). Do the power differentials exhibited in intra-elite contests to secure business model rules constrain elite agency more than the intra-elite contest rules? The latter provide a more stable framework for development if there is elite cohesion and a comprehensive separation of powers. Yet any law or its *de facto* impact (see Figure 4.3 which distinguishes between business model rules and intra-elite contest rules) is amendable if there are sufficient power differentials, sometimes employed midway through an intra-elite contest through lawsuits, novel legal interpretations, *ad hoc* regulations and ordinances, presidential decrees, and various forms of rule *by* law rather than the rule *of* law (see the discussion in Section 4.3.2 on meta-institutions and the rules that change institutions).

Business model rules function to constrain non-elites and their value appropriation options. Intra-elite contest rules function to constrain losing elites. The applicable business model rules are an expression of intra-elite contest outcomes. A simple 'follow the money' heuristic to identify the causes of institutional change would suggest that *cui bono* ('who benefits') from institutional change has likely instigated it. For instance, Janet Yellen conceding that "she was 'wrong' about inflation threat" (Politi, 2022) is misleading, as business model rules (interest rate changes are *de facto* such a rule) are not amended by error or accident if elites have agency. Wherever there are significant residual income flows, investments by a business model in changes to the political economy rules have channeled these. To understand inflation or any other inclusive or extractive phenomena in the economy, it is important to 'follow the money' and determine who benefits. The *cui bono* analysis of the political economy likewise applies to institutional change that originates in the narrative market arena (e.g., tariffs and sanctions, diversity, equity, and inclusion (DEI), universal healthcare). After all, the human beings of North's "humanly devised constraints" are elites. Normatively, the *cui bono* agents that succeed in effecting both inclusive and extractive institutional change would be those *qui generat valorem* (consistent with the maxim, *To the creators the value created*, see the set of ethical principles in Chapter 8 as well as 'A Weighted Structural Reform Framework' for policy in Table 7.1).

4.2.3 Discrete conceptualizations of elite embeddedness for elite business model rules and intra-elite contest rules

Elites as the central agents of the economy are posited to be at the deepest level of what Seo and Creed (2002) refer to as the "paradox of embedded agency". This paradox is important, and two formulations follow:

> How can actors change institutions if their actions, intentions, and rationality are all conditioned by the very institution they wish to change? (Holm, 1995, p. 398)

> If institutions are, by definition, firmly rooted in taken-for-granted rules, norms, and routines, and if those institutions are so powerful that organizations and individuals are apt to automatically conform to them, then how are new institutions created or existing ones changed over time (DiMaggio & Powell, 1991)? (Seo & Creed, 2002, p. 222)

The paradox of institutional change is theoretically not easy to handle, and neither are the accounts that seek to explain it:

> In neo-institutional theory, changes to institutions are usually explained by disruptions to the institutional order. [. . .] Therefore, explaining an institutional change in situations that lack disruption of the institutional order or exhibit institutional plurality and complexity appears to be valuable. (Goldenstein & Walgenbach, 2019, p. 136)

In early neo-institutionalism, agents were "implicitly assumed to have a limited degree of agency" and so complied with institutional pressures (Battilana & D'Aunno, 2009, p. 31). Such institutional determinism is obviously problematic when evaluating institutional change in support of a new business model. Another original weakness of such neo-institutionalist conceptions of institutional formation and change is its inconsequence for practice, as articulated by Hodgson (2000, p. 318): "Although institutional economists are keen to give their theories practical relevance, institutionalism itself is not defined in terms of any policy proposals". This position shifted because of ambitious visions for the field exemplified in works like "Institutions as the Fundamental Cause of Long-Run Growth" (Acemoglu, Johnson, & Robinson, 2005) and progress in the understanding of specific phenomena like poverty traps. Theoretically, and in dialectical fashion, Seo and Creed (2002, p. 240) eschew neo-institutionalism's agents "as passive recipients of institutional frameworks", but also as the "unconstrained" utility-maximizing agents of North (1991b) using the proactive manipulation strategies of Oliver (1991). They then settle between these "extreme positions" on a middle-way that sees institutional change and human agency conceptualized "as praxis", action that is "conditioned but not determined by existing social arrangements" (Seo & Creed, 2002, p. 240).

The metaphorical 'room' of Giddens (1984) is also an intermediate approach: the agent is within "the walls of a room from which an individual cannot escape (signifying 'embeddedness'), but inside of which s/he can move around at whim (signifying 'agency')" (Lok & Willmott, 2019, p. 470). The idea here is that "the relation between

structure and agency is understood as mutually constitutive; or, as Bourdieu and Wacquant (1992, p. 20) incisively put it, as 'ontologically complicit'" (Lok & Willmott, 2019, p. 470). Cardinale (2018, p. 132) proposes an approach to set the microfoundations for institutional theory where "structure not only constrains and enables action but also actively orients it toward some possibilities over others". While he claims that such an approach will "bridge long-standing divides within institutional theory", he is taken to task by Lok and Willmott (2019) on account of his two-level conceptualization of embeddedness, the desire to connect structure and agency (which to them are not partially autonomous juxtaposed forces but "mutually constitutive" with action shaped by structural conditions). In practical and theoretical terms, is agency enabled and constrained "by" (Cardinale, 2018) or "through" (Lok & Willmott, 2019) structure and institutions? Given the elite theory's integration with practice, elite agency is deemed to happen "through" structure rather than being acted upon "by" structure, in alignment with Gidden's theory of structuration (1984, p. 25) where the "constitution of agents and structures are not two independently given sets of phenomena, a dualism, but represent a duality".

This elite theory is expeditious in its conceptualization of the relationship between (elite) agency and institutions. Clearly, Giddens' room and its features are the accumulated institutional changes brought about by previous generations of elites (driven by their business model preferences). Yet there is an area surrounding the room that is of great interest for general development purposes. Emergent or rival elites with sufficient power from their wins in the political economy's three arenas (market, non-market, and narrative market) creatively force their way through the room's walls or ply their trade outside, notably in the adjacent spaces opened up by technological shifts or narrative possibilities. Institutionally, these are self-similar offshoots, sometimes a reduced version of the original, but in cases when new technological advances allow, a scaled-up version of the original fractal patterns—normatively, value creation patterns ought to take precedence. In time, however, emerging elites erect a roof over the fresh walls of their new domain and fervently protect it while accumulating power (Figure 4.5 describes the lifecycle of elite business models). As far as the bargaining power differentials permit, and when incumbent elites fail to reinforce the existing barriers, lock the exits, or shrink the space, the newcomers either take over or simply dismantle the old structures. In this work, institutions are the rules that constrain elite agency insomuch as there are power differentials between elites in the context of intra-elite rivalry. Institutions are the accumulated change layers of temporally resolved intra-elite contests—they "are both the medium and outcome" (as in "the duality of structure" outlined by Giddens, 1994, p. 25) of the winners. The constraining effects of institutions matter in terms of value appropriation, but in the main these apply to non-elites and elites that are on the losing side of intra-elite contests. A different and more significant constraint on winning elites, though far from airtight, is the set of rules that govern intra-elite contests, such as elections or the budgeting processes of a state.

Lobbying (see Hall & Deardorff, 2006; Lowery, 2007; Baldwin & Robert-Nicoud, 2007; Smith, 2018) by organized interests "to affect what the government does" (Nownes, 2006, p. 5) is sometimes the visible hand of agency driving institutional change and has long been

recognized as such: "Adam Smith [. . .] offered trenchant discussion of the activities and effects of mercantile interest groups" (Tollison, 2012, p. 74). Lobbying has become so visible, institutionalized, and sophisticated that the management literature now employs the more extensive term of corporate political activity (CPA). CPA encompasses and distinguishes between discrete activities like political action committees (PACs) and contributions or donations to electoral campaigns (Hillman, Keim, & Schuler, 2004), where the "nonmarket strategy refers to a firm's concerted pattern of actions to improve its performance by managing the institutional or societal context of economic competition" (Baron, 1995; Lux, Crook, & Woehr, 2011, as cited in Mellahi, Frynas, Sun, & Siegel, 2016, p. 144). When successfully carried out via elite coordination leadership, the direct agency of a coalition's political elites in the non-market political arena, supported by more indirect agency in the narrative market arena, brings forth the institutional changes required for its business model's residual income objective. Acemoglu, Johnson, and Robinson (2005, pp. 406–407) note that: "Bad institutions are therefore kept in place, clearly not for the benefit of society as a whole, but for the benefit of the ruling elite, and this is a pattern we encounter in most cases of institutional failure". Institutional failure is therefore cumulative institutional change in support of extractive elite business models (or its failure to support inclusive models). Lobbying activities (a prime manifestation of 'political economy know-how', see Figure 2.3), have been linked to rent seeking in work by Tullock (1967) and Buchanan (1980, p. 14) who see nonmarket interactions working side-by-side with Smithian competitive markets (requiring 'knowledge') to shape institutional formation and change. The subtlety of institutional change achieved through lobbying varies, as documented by the US Senate Special Committee to Investigate the National Defense Program in the context of WWII:

> Such corporate executives in high official roles were too inclined to make decisions for the benefit of their corporations. "They have their own business at heart", [Senator] Truman remarked. The report called them lobbyists "in a very real sense", because their presence inevitably meant favoritism, "human nature being what it is". (McCullough, 1992, p. 265, as cited in Williamson, 1993, p. 81)

Despite the critical assessment above, lobbying, which plays out as part of the set of checks and balances between business and political elites (see Table 3.2; intra-elite power relation 4), can lead to sustainable value creation—though this depends on the elite business model that is being advanced. The ETED's general position is that institutional change, including inclusive change, is caused by elite business model preferences. As elite business models backed by bargaining power differentials materialize, elite agency fashions new institutional layers. Institutions are the embodiment of cumulative elite preferences for rule formation and their change. At the same time, the analysis of institutions as constraints benefits from their separation into the two categories considered earlier—and now depicted in Figure 4.3—subject to a discrete examination of their formation and change: business model rules and intra-elite contest rules.

Mahoney (2000, p. 507) notes that "path dependence characterizes specifically those historical sequences in which contingent events set into motion institutional patterns or event chains that have deterministic properties". Libecap (2011, p. 64) discusses "institu-

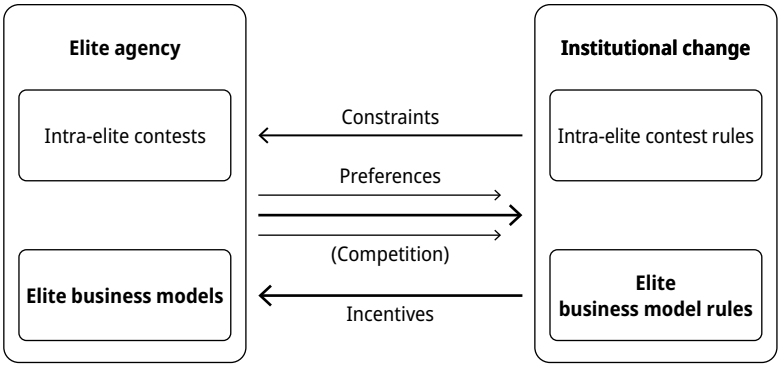

Figure 4.3: Elite business model rules and intra-elite contest rules in the elite agency microfoundations of institutional change model.

tional path dependence" and elucidates how "past arrangements to meet conditions of the time constrain contemporary economic opportunities. They cannot be easily significantly modified or replaced ex post". In theorizing the 'elite business model critical junctures' conjecture (Sections 4.3.4 and 5.1.1), the ETED's view of institutional change articulates the importance of such inflection points but does not obviate institutional stickiness or momentum. Rather, 'elite business model agglomeration' underlies Libecap's assertion that institutions "cannot be easily significantly modified or replaced ex post". Surely, while institutional inertia and structuralist traps are real, these can be counterbalanced by the 'inextinguishable value creation option of elites' (Figure A5.4c) or other less edifying expressions of their agency. Business model transformation or new forms of extraction are always possible, as are switches in the institutional path associated with business model rules (see Section 2.2.1). The latter, requiring enormously strong elite transformational leadership (see Table 7.2) to counter the agency of rival elites are, when inclusive, activated via the rules of intra-elite contests or by the use of naked power (see the role of power as a meta-contest resolution mechanism, Section 4.3.2).

Elites are primarily subject to peer constraints in political economy contests, but to a lesser extent are also affected by non-deliberate rules, including tradition or extra-legal self-organization (see Section 4.2.4). The rules of intra-elite contests, which approximate the concept of meta-institutions put forward by Mokyr and Nye (2007)[65], ought to mediate how competing elite preferences succeed in changing the business model rules, relative power notwithstanding. Cumulative institutional changes affected by previous generations of elites set such rules and these weigh heavier on elites than any other constraints (again, it is eas-

65 The construct as used in the ETED does not reference Stepan's (2001) advancement of the term, but rather approaches Lorini's (2014) "'meta-institutional concepts'" [which] are concepts that are conditions of possibility of institutions", and so constitute a "new level of the structure of institutional reality" (Polyakova, Nesterenko, & Sverdlikova, 2019, p. 140).

ier to change business model rules). Still, the elite coalitions with a profitable business model and enough power can break through most accumulated institutional constraints. For example, the institutions of central banking in the West lived up to their mandates for price stability to successfully mollify inflation for nearly four decades, yet this painfully extractive business model was suddenly and effortlessly reactivated by elite agency in 2021.

The integrity of the intra-elite contest rules in the political economy (e.g., a functioning justice system) is crucial, as it is often the backstop against overly extractive models. These rules require a degree of elite cohesion to be in place and are maintained in circular fashion by the elite separation of powers this instigates. Elite cohesion possesses cultural bases, and the "two-way causal effect between culture and institutions" theorized by Alesina and Giuliano (2015, p. 898) has a discrete impact on intra-elite contest rules. Inclusive institutional change then results from a powerful coalition set on elite business model transformation and a degree of consensus among elite coalitions that are otherwise competing and at odds with each other, i.e., a modicum of elite cohesion (the core elite coalition has an important role to play here, see Table 7.2). Stable intra-elite contest rules in turn support elite cohesion and consolidate a culture of robust intra-elite contests and the legitimacy of separation of powers arrangements. The delicate balancing act needed for these conditions to be met (see the 'intra-elite quality contest' dilemma, Figure 5.2) and the capricious nature of intra-elite contests make it highly difficult *ex ante* for a single coalition to predict rule changes and how these will affect its business model. Coalitions in the elite system will have agency but still need to deal with the complexity, non-linearity, emergence, evolution, and non-repeating patterns described in systems theory (see Section 3.2.3, and Von Bertalanffy, 1969/2003; Parsons, 1951/1991; Gleick, 1987; or O'Connor, 1994). *Ex post*, however, all rule changes emanate from the agency of identifiable elites.

A mandate of elite system transformational leadership (discussed in detail in Sections 6.3.2 and 7.2.4) is securing intra-elite contest rules that act as incentives for competitive intra-elite contests and minimize the negative externalities of such contests. For example, such conditions are evident in Swiss referenda, the "Elections Clause" of the US Constitution (Article I, Section 4, Clause 1) that specifies the respective powers of Congress and the states regarding "The Times, Places and Manner of holding Elections for Senators and Representatives", or the Hatch Act of 1939, which constrains the political activities of federal civil servants. In the mid-1990s, the new elite coalitions that had emerged under President Boris Yeltsin in Moscow took a step consistent with such leadership by deciding on a *de facto* rule for intra-elite contests that included an injunction against violence as a means of solving their business disputes.[66] It is, nonetheless, busi-

66 The deinstitutionalization of intra-elite contests now seems more prevalent, as the analysis of events at the "Amazon of Russia" in *The Moscow Times* illustrates: "The bullets flying at Moscow's Wildberries HQ last week are a chilling sign that Russia's wild 1990s are back with a vengeance. [. . .] In a deadly shootout straight out of a mobster's playbook, the violent chaos that once ruled the streets has returned to the Moscow boardroom, leaving two dead and the nation wondering whether Russia's ruthless past ever really went away" (Corcoran, 2024).

ness model rules that have the more direct and tangible impact on positive economic development. These are determined by the interactions between competing elite preferences within the constraints of intra-elite contest rules on an ongoing basis.

In short, the focus of this discussion has been on the two types of institutional rules relevant to an elite theory of economic development—intra-elite contest rules and business model rules—and their respective conceptualizations of embeddedness. The former are fundamental, comparatively constraining, and stable, while the latter are more bound by immediate elite agency and ought to be in flux in a dynamic economy characterized by technological and social progress.

4.2.4 Additional support for institutional formation and change by elite agency

Which existing theoretical positions best explain the formation of institutions considering their heterogeneity in practice (Ostrom, 2005), and which of these are consistent with the proposed explanation of elite agency as a key driver? Early on, Menger (1883/1985) suggested two modes of institutional formation: deliberate/pragmatic and spontaneous/organic, both of which later underwent further development (Chavance, 2012, p. 43). That is, some theories "emphasize the deliberate creation of institutions through the political process, while others emphasize the spontaneous emergence of institutions through evolutionary processes" (Kingston & Caballero, 2009, p. 151).

The theoretical position of this work discussed above aligns with Commons' emphasis on the former mode for both the formation and change—deliberate, by elite agency—of institutions, while deemphasizing the Veblenian, Hayekian, and Austrian stress on spontaneous formation and structuralist leanings. For instance, this elite theory qualifies the stance of Hayek, who "opposed the view that institutions were 'deliberate contrivances', arguing instead that they emerged through trial and error across generations" (Bowles, Kirman, & Sethi, 2017, p. 216), by emphasizing the strategies and resources behind the 'trials' and the systematic learning in intra-elite contests, including the corrective measures made by elite coalitions to 'errors' and the confirmatory actions taken as a result of wins. This position is held even in light of the critique against Commons' "failure to give sufficient emphasis to extra-legal institutions, extra-legal self-organization, or spontaneous orders that do not involve legal rules" (Hodgson, 2003, p. 547), and despite the emphasis on purported "cultural norms" behind "responsive and inclusive elites" (Welzel, 2002, p. 269). Elite agency is agile, employs surprise, arbitrages institutions, leverages institutional voids, builds on culture, and improvises. Moreover, without its fundamental pursuit of self-interest (elite business model preferences), the formal *and* informal institutions (of business model rules) are purposeless, conflicted, and messy, or of scant relevance for economic development. Institutional evolution, even with its cycles of Hayekian trial and error, haphazard appearance, and unpredictability is always driven by elite agency, as is posited in the 'follow the money' heuristic, the *cui bono* of institutional change. This

notion also extends to deregulation and deinstitutionalization, "the processes by which institutions weaken and disappear" (Scott, 2001, p. 182). One such interesting instance is the successful effort by Wall Street investment banks to liberalize the financial markets by lobbying for the Clinton Administration's Financial Services Modernization Act of 1999 (also known as the Gramm-Leach-Bliley Act) that signified the repeal of the Glass Steagall Act of 1933, the regulatory framework that constrained the speculative activities that had caused the 1929 crash. It was Allan Greenspan and his Federal Reserve Board (FRB) that opened the floodgates for this by exploiting a temporary loophole in the anti-affiliation constraints of the Bank Holding Company Act of 1956 to license and concoct the first universal bank since the Great Depression, the merger of Travelers with Citicorp, thus creating what was then America's largest bank. While the new Citigroup soon span the Travelers unit off in 2002, the approval of the merger paved the way for the US Congress to destroy President Franklin D. Roosevelt's legacy of nearly seven decades of financial stability and constraints on value transfers. For human and economic development, the institutions that really have impact are those associated with the rules for the value creation and transfers of elite business models. These, or their absence, are the 'deliberate contrivances' that matter. In the example above, Clinton's institutional change for 'modernization' in the finance industry triggered a surge of transfer activity and created the conditions for the Great Recession in the pivotal period between 2007 and 2009.

Can these deliberate contrivances be irrational and thus support structuralist arguments and the spontaneous formation of institutions? For instance, in the field of ESG, Edmans notes that: "irrational sustainability involves pursuing a project, investment, or certification just because it is viewed as sustainable" (2024, p. 13). In fact, behavioral economists have long identified many institutional inconsistencies: "legal statutes are less tolerant of carcinogens in our food than in our drinking water or our air" (Fischhoff, Lichtenstein, Slovic, Keeney, & Derby, 1980, p. 2); "In the United Kingdom, 2,500 times more money per life saved is spent on safety measures in the pharmaceutical industry than in agriculture (Sinclair, Marstrand, & Newick, 1972, as cited in Fischhoff, Lichtenstein, Slovic, Keeney, & Derby, 1980, p. 2); "According to some calculations, U.S. society spends about $140,000 in highway construction to save one life and $5 million to save a person from death due to radiation exposure (Howard, Matheson, & Owen, 1978, as cited in Fischhoff, Lichtenstein, Slovic, Keeney, & Derby, 1980, pp. 2–3)". In light of such evidence, behavioral economics could claim "incoherent policies save fewer lives at greater costs than other possible policies" (Messick & Bazerman, 2001, pp. 220–221). Yet to this inquiry, the ensuing prescriptions would seem naïve: "We can protect ourselves from such errors by improving the judgments of managers in the private and public sectors" (Bazerman, 2001, p. 43). Theoretically, mainstream economics and the RCT paradigm (Allison & Zelikow, 1999) are admittedly hard pressed to handle irrationality or even build "Rational Models of Irrational Behavior" (Akerlof & Yellen, 1987), while "bounded rationality" (Simon, 1957) acknowledges imperfect information and cognitive limitations, and behaviorism relies on

biases and heuristics to explain judgments made under uncertainty in the economy (Tversky & Kahneman, 1974; Kahneman & Lovallo, 1993). It is true that inconsistent rules are the "failure to explicitly deal with risk tradeoffs" (Messick & Bazerman, 2001, p. 221) and it is therefore essential to systematically weight and offset these in policymaking. Yet this can only be done in a political economy that recognizes elite agency. This work's theory contends that institutional anomalies, whether they are the residual leftovers of anachronistic political processes or genuine errors of judgment, are best dealt with through the lens of elite agency and the *cui bono* analysis.

For instance, "Bork used the institutional irrationality theme to drive home his case for change" with a "depiction of a powerful regulatory system gone mad", describing "the U.S. antitrust system as prone to erratic swings in policy" (Kovacic, 2014, p. 858). If antitrust law, or any other business model rule—irrational or not— is harmful to powerful elite interests, it will be contested. The sweeping victory of Bork's narrative controverts his position by demonstrating that elite agency will fix any irrationality when the interests of a sufficiently powerful business model are at stake. Rules that support any remaining anomalies are simply irrelevant or subordinated in the face of the force of elite coordination leadership. Lastly, and returning to safety legislation, there is technically no way to disagree with: "By using a consistent value of life for all products, one minimizes the total chance of death from all products" (Owen, 1981, p. 715). In the political economy, inconsistencies characterize the value of life through eminently straightforward *cui bono* explanations. Institutions are deliberate.

Hall and Thelen (2009, p. 9) emphasize that a "sophisticated understanding of institutional change" is "not incompatible with dynamic views of the political economy". This can be affirmed in even stronger terms: the political economy is a distributional game with winners and losers; the feasibility of distribution of value strategies are determined by institutional formation and cumulative institutional change driven by elite agency. This idea is now cemented with some illustrative examples.

Smartphone ride-hailing is demonstrative of how institutions (and non-elite stakeholder positions) are shaped by elite agency in support of its models. In their intra-elite contests with traditional taxi firms, Uber (see the *Uber Files* reference in Section 3.3.3) and Lyft gained ride-hailing licenses from institutions "municipality upon municipality" with few exceptions (Brail, 2018, pp. 52, 55). When, in 2003, Taobao offered a "custodial transactions" feature without a proper license and was warned of the legal consequences, Jack Ma's response was "If someone has to go to jail, I'll go" (Wu, 2019). His boldest move into Internet finance came in 2013 with the launch of *Yu'ebao*, a money market fund "for the masses" retailing "through PayPal-like Alipay" (Mu, 2014), even though Alibaba still lacked a banking license (which was only granted by the China Banking Regulatory Commission the following year, in 2014). As a result of such institutional arbitrage, by 2020, Ma's Ant Financial empire had successfully re-shaped Chinese industry with a business model valued at US$ 225 billion (Xie & Yang, 2020). Yet, in a reversal that made international headlines, the political elite checked the business elite (see Figure 3.2; intra-elite power relation 4) as Ant

Financial's public offering, the world's largest-ever, was suspended on November 5, 2020, a few days before its expected trading debut to the relief of incumbent banking elites who would have been at the receiving end of data asymmetries. What Jack Ma had dared do, Jeff Bezos or Mark Zuckerberg would not.[67] Thereafter, China's market regulator got generally tougher on Big Tech and its perceived market dominance-driven extractive value transfers, and China's State Administration for Market Regulation noted:

> Antitrust complaints against platforms are increasing by the day, and make clear that the development of the online economy has come with some risks for competition. (Yang, 2020)

Is this sequence of institutional changes, first driven by the will to create and appropriate value and then by a counterresponse from the system's core coalition to purportedly curb the power of monopolies and prevent transfer-IN from non-elites, a desirable approach to revitalize competition and support emerging elites and elite circulation, while placing a proper political power check on economic power? Structural reform questions such as these are essential to economic development. From Veblen (1904/1975) to Acemoglu and Robinson (2013b), institutions and their incentive structures are posited to constrain elites. Every time a model is institutionally sanctioned, the winning elites, Streeck and Thelen's (2005) "rule makers", force the losing elites to become "rule takers", at least until the next round of the contest. Ant Financial did not prevail in the political economy's non-market contest arena (see Figure 3.6), and institutional change was implemented against its preferences to the benefit of competing elites, especially rival financial institutions, including state owned ones. While still a formidable elite business model, Ant Financial accepted the new rules that now constrain and diminish it.

The above does not mean that non-deliberate, spontaneous, and organic factors have no influence on institutional formation and change. Accidents, traps, and traditions matter, and Knightian uncertainty is pointedly relevant to the single elite coalition's agency. The emergence of viral 'orphan' narratives, devoid of elite godfathers, also causes degrees of both inclusive and extractive institutional change (e.g., cryptocurrencies, BLM, or even anti-vaccination narratives in some countries). But like any contingency or custom they end up being captured and integrated, as this is part of the mandate of capable elite leadership. Institutions, like narratives, can have a logic, life, and an inertia of their own—at least for a while—even if they all eventually end up in the service of one elite business model or another.

Elite agency as a microfoundation of institutional formation and change places elite business models (and their aggregate agency) at the center of society and the

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67 In the US, Silicon Valley and Wall Street harness their synergies, yet the current technological shift might skew the power equilibrium vis-à-vis political elites. Pundits like Aschenbrenner propose the "AGI government project" (2024, pp. 145, 153) that, while using a geopolitical rationale, aims to *de facto* restore a classical balance in intra-elite power relation 4.

economy due to their outsized impact on the inclusive or extractive nature of national institutions. Sustainable value creation measurements (such as the VCp/VCr) of elite business models then predict economic and human development to a degree that this inquiry suggests no other variable does. Uncompetitive manufacturers explain tariffs, competitive exporters explain free trade, and the interests of trade unions explain minimum wages above the equilibrium and inflexible labor laws (even in the face of excessive levels of youth unemployment in countries such as Spain or Argentina). Since the work of Coase, North, and new institutional economics, institutional arrangements have been widely recognized as being as important for macroeconomic performance as fiscal or monetary policy. Yet the intimate links between institutions and elite business models, and the value creation implications that the latter have on society, are manifestly underrepresented in policy agendas, econometric models, or the public discourse. To address this deficit, frameworks for policymaking are advanced (from Chapter 6 onwards) on the premise that elite business models are antecedents of institutional change (or the lack thereof), and thus the definitive drivers of economic and human development.

Elites, due to lower transaction costs, high levels of trust, and concentrated (business model) interests, secure 'the extraordinary lever' in their particular fields as they consolidate wins in the political economy's three contest arenas that emanate from their coordination leadership. Victories against rival elites lead to the accumulation of power and then to institutional change in the form of rules favorable to their business models. A deeper dive into the nature of power is the focus of the next section before the chapter concludes the discussion on institutional change by establishing its endogenous nature (Section 4.3.5).

4.3 Power and elite agency

Ample research has documented how agency impacts institutions. DiMaggio (1988) brought "agency and interests directly into the relationship between power and institutions", but the analytical links between institutions and power in organizational fields still remain immature (Lawrence & Buchanan, 2017, p. 477). Proposition 8 addressed this issue by linking bargaining power differentials to elite business models, through the lens of the VCA framework. 'The extraordinary lever' that power (applied coordination capacity, see Figures A5.3a or A5.3b) confers to those atop social hierarchies is further elucidated in subsequent sub-sections to scrutinize the relationship between elite agency and power. These begin with an examination of power's coordination function in society (4.3.1), and continue with the assertion that power serves as a meta-contest resolution mechanism (4.3.2). Since power differentials are the ultimate movers of institutions and the economy (4.3.3), it is the power of elite business models that resolves critical junctures (4.3.4). In the final sub-section of Chapter 4

these diverse reflections on power are brought together by an affirmation of the endogenous nature of elite business model driven institutional change (4.3.5).

4.3.1 The omniscience of power and the formation of a common will

Denord, Palme, and Réau's comprehensive study of elite research theory and methods focuses on the concept of power (2020), while Hoffmann-Lange is unambiguous: "Power and elites are universal social phenomena" (2007, p. 910). Power was earlier examined from a management science perspective in terms of the role it plays during bargaining for value appropriation (in the form of revenue and profits) in principal-stakeholder relationships. But what is the general, deeper nature of power? Foucault (1982, pp. 778, 791) claims that: "Power is everywhere; not because it embraces everything, but because it comes from everywhere" and as a result, "to live in society is to live in such a way that action upon other actions is possible—and in fact ongoing. A society without power relations can only be an abstraction". Pareto is more specific, defining power as the ability to coordinate and control (Powers, 1981, p. 104). Consistent with Proposition 4 on coordination capacity and lower transaction costs, one source of power are the "positions in a network of relations" and specifically network centrality (van der Eijk, 2018, p. 99), while "the power of social elites depends strongly on the structure of the network in which they reside" and having control of a network is "power to effect change" (Siegel, 2009, p. 123). Nonetheless, and as discussed in Section 4.1.2, a structuralist SNA analysis is insufficient to explain power, since elite agency in all its leadership varieties comes into being against the backdrop of uncertain intra-elite contest dynamics. Powerful figures certainly benefit from 'the power multiplier' effect underlying 'the extraordinary lever', but this construct is built by their deliberate agency. Its amplification mechanism leverages social hierarchies, network effects, and the successive principal-stakeholder relationships along the economic value chain (Section 1.3.4, see also Figure A5.3a).

Habermas and McCarthy (1977) contrast two notions of power: first, Max Weber's (1925, pp. 1:16, 2:1, as cited in Habermas & McCarthy, 1977, p. 4), where "power means every chance within a social relationship to assert one's will even against opposition", i.e., social coercive agency (*Zwang*); and second, Hannah Arendt's communicative action model that goes beyond power as force (*Gewalt*) and is especially relevant for this theory's understanding of elite business models and elites. To Parsons, power is "a facility for the performance of function in and on behalf of the society as a system" (1957, p. 139), while Arendt's communicative action model also places power at the collective level relates it with coordination capacity:

> Power corresponds to the human ability not just to act but to act in concert. Power is never the property of an individual; it belongs to a group and remains in existence only so long as the group keeps together. When we say of somebody that he is "in power" we actually refer to his being empowered by a certain number of people to act in their name. (Arendt, 1970, p. 44, as cited in Habermas & McCarthy, 1977, p. 4)

Powerful principals 'acting in the name of others' may or may not act in the interest of the stakeholders from which their power emanates. Power has often been conceptualized dualistically in both its repressive or productive employment (Hörnqvist, 2010). Foucault underscores non-elite animadversion against elite dominance but acknowledges that "the exercise of power can produce as much acceptance as may be wished for: it can pile up the dead and shelter itself behind whatever threats it can imagine", while also accepting that "every relationship of power puts into operation differentiations" which encompass "differences in know-how and competence" (1982, pp. 789, 792, 795). Power can be used for both value creation and extraction. After all, power "has collective as well as distributive functions" (Parsons, 1957, p. 139) and resolves value appropriation outcomes (see bargaining power in Proposition 8). Its appropriative nature is illustrated by the following example:

> In the US South, even though political institutions changed in such a way as to redistribute de jure political power away from the white elites, the elite was still very cohesive as a group. As a consequence, they were able to compensate for the change in political institutions through the use of de facto power. It is perhaps not surprising that the plantation elites had such a relative advantage over the newly freed slaves in terms of their ability to act collectively. In consequence, they maintained their political control. (Robinson 2010, p. 10)

The plantation business model persevered *de facto* if not *de jure* because Southern elites excelled at providing value to their customers; elite business models generally endure as long as elite networks retain their lower transaction costs and cohesion and exercise effective elite coordination leadership. New power sources across all three of the power domains (economy, politics, and society, see Figure 1.2) are obtained to compensate for any circumstantial losses and setbacks and rebuild 'the extraordinary lever'. The plantation owners forfeited power in the non-market arena ('might' in the politics power domain) during the Civil War, but after the Reconstruction era (1865–1877), the material institutional arrangements stayed in place (e.g., plantations were not expropriated). In the market arena ('money' in the economy power domain), wins could then be netted (e.g., from demand for cotton and tobacco). Even in the narrative market arena ('mind' in the society power domain), the once defeated Southern elites experienced quite a comeback, manifested in works such as D.W. Griffith's *The Birth of a Nation* (1915). These wins in turn led them to recover much of their pre-Civil War power in the political non-market arena (as evidenced by Jim Crow legislation, or Black Codes). These examples of arbitrage across power domains showcase how 'might' is directly converted into 'money' (i.e., wages were below 'equalized bargaining power equilibrium prices' see Section 2.2.2).

Narratives are the form of power (see Proposition 14) most resilient to the test of time. The power of narratives ('mind') in the society power domain has something of the miraculous, in both positively inspirational and far less edifying ways. As long as they are not forgotten, narratives can overturn institutional arrangements (as was the case with the elites in the Southern US states after 1877), allow a people to persevere

in the cruelest of circumstances (Sephardic Jews blossomed in Amsterdam after the expulsions of 1492 and 1497), and even cheat death (the tragic Smolensk air disaster that killed Polish President Lech Kaczyński and many members of the Polish elite on April 10, 2010 did not dent their Law and Justice party, and its narrative has continued to thrive). It is easy to overlook that in each of the preceding examples, the elite coalition narrative competed against rivals in the narrative market arena, and narrative wins typically facilitate power accumulation in the fiercely contested non-market and market political economy arenas.

The amassing of power in one domain needs to be followed by wins in the other two. How these three power domains—each with their own contest arenas—synergistically work together for a coalition is demonstrated by a historical elite business model critical juncture. This is the case of an emerging elite trying to break free just as much from a narrative that supported the notion of 'purgatory' borne out of Parisian theology (Vincent, 2002), as from one specific elite business model activity that this doctrine sustained: papal indulgences. Martin Luther's Reformation challenge to the extractive business model of the Catholic Church started with his new Protestant elite coalition winning an important share of 'mind' in German narrative market arenas by disputing that sins could be atoned for by payments to Rome. But power also had to be won by Protestant elite coalitions in the political domain's non-market arena—the bloody battlefields of the Thirty Years War and its 8 million dead (Wilson, 2008, p. 554). The newfound power ('might') attained by enduring in the wars against stronger incumbent forces gave wings to the Germanic princely elite business models that, no longer 'taxed' by the Vatican, added economic power ('money') to their endowments. With the Protestant and "German liberties" narratives at the forefront, local elites replaced the Vatican and its extractive institutional arrangements in many areas of Western Europe.[68]

Elon Musk at Tesla—before jumping on the Trump bandwagon and the subsequent "showstopping breakup" (Schwartz & Maidenberg, 2025) notwithstanding—serves as a contemporary illustration of successful business model leadership that has attained bargaining power endowment differentials across principal-stakeholder relationships in the three power domains of economy, politics, and society. A very skillful operator of narratives, Musk's elite coordination leadership enlisted both elites and non-elites to score wins for its electric vehicle (EV) business model (positioned in opposition to the traditional combustion engine automotive). News agencies reported on the institutional

68 This is not to say that Martin Luther's Reformation was devoid of extractive elements. Quite the opposite, as he "fought for the subjugation of the Jewish people" (Kaufmann, 2019, p. 46), and in the *Bauernkrieg* (War of the Peasants, 1524–1526), "He rejected outright the peasants' protests against serfdom on the basis of biblical injunctions. He insisted Scriptures accepted the fact of human slavery" (Kuenning, 1987, p. 313). To cap it all and in tune with the unenlightened times, "he could not perceive women as learned in any way. Women do not write books, he claimed, and women are men's servants" (Classen & Settle, 1991, p. 235).

change that Musk's narrative market wins in the society power domain ('mind') brought about in politics power domains across the world ('might'); twin wins that eventually led to further victories in the economy power arena ('money'), with all three power types eventually converting into residual income, profits, and more 'money'[69]:

> In the US where "the federal government is subsidizing electric cars with a $7,500 consumer tax break"; in Norway where "the country government exempted battery-powered vehicles from the 25% value-added tax imposed on petrol and diesel engines"; and in China with a "generous five-year subsidy program for so-called new energy vehicles". (Reuters, 2020)

Whether Weber's assertion of will against opposition (as cited in Habermas and McCarthy, 1977), Parsons' (1957) "collective" and "distributive" functions within a system, Arendt's (1970) notion of power as an "act in concert" with the "formation of a common will", Coff's (1999) capacity for "unified action", or Musk's applied EV narrative; in political economy terms, all power gains further leverage by moving institutions and bringing about the implementation of preferred elite business model rules. Mills articulates the relationship between power and institutions as follows:

> By the powerful we mean, of course, those who are able to realize their will, even if others resist it. No one, accordingly, can be truly powerful unless he has access to the command of major institutions, for it is over these institutional means of power that the truly powerful are, in the first instance, powerful. [. . .] Not all power, it is true, is anchored in and exercised by means of such institutions, but only within and through them can power be more or less continuous and important. (Mills, 1956, p. 9)

The power obtained in the domains of politics, the economy, and society to fuel elite agency is ultimately manifested as collective action at the coalition (micro), elite system (meso), and political economy (macro) levels through elite coordination leadership. Power is eventually converted into residual income (also 'money') via elite business model leadership. Institutional change is a nexus between the two forms of leadership. Power in all three domains is the outcome of elite coordination leadership and a necessary input for, and one of the outcomes of, elite business model leadership (as represented in Figures 4.1, 4.4, and A5.3). Power is now examined from an intra-elite contest resolution perspective to further discern its functional equivalence to institutions.

69 Residual income or profits are also 'money', but of the freely disposable variety. Profits and their aggregation as wealth can be employed beyond the power accumulation purposes of the business model and be used for disparate investments (e.g., Musk taking Twitter private at a cost of US$ 44 billion in October, 2022), conspicuous consumption, or philanthropy.

4.3.2 Power is a meta-contest resolution mechanism that bests institutional processes

> What I want particularly to stress is that the solution is essentially the transformation of the *conflict* from a political *problem* to an economic transaction. An economic *transaction* is a solved political problem. Economics has gained the title of queen of the social sciences by choosing *solved* political problems as its domain. (Lerner, 1972, p. 259)

Why are economic transactions solved political conflicts? Because of the workings and nature of institutions, power, or both. Institutions are the low-cost dispute resolution mechanism par excellence. The dispute resolution view of institutions proposed by Commons (1950) was summarized by van de Ven (1993) and articulated by Williamson (1993, p. 78) as "a response to scarcity and conflicts of interest" with the "transaction as the basic unit of analysis". DiMaggio's critique of institutional change appreciates "conflict-laden processes that define fields and set them upon trajectories that eventually appear as 'natural' developments to participants and observers alike" (1991, p. 268 as cited in Scott, 2008, p. 437). Commons further argues that: "the negotiational, organizational political economy is the way contemporary collective capitalism works" (Elliott, 1978, p. 105). Institutions solve transactional conflicts in a cost-efficient manner by providing the framework for negotiation. Bargaining power is also important in such negotiations and can be the decisive factor in solving conflicts. It might even do so at low cost by directly nudging the transaction into the spaces where institutions are either missing or not able to complete the task by themselves.

Institutions might be deficient in a political economy but power is always present in socio-economic relations (see Foucault, 1982) and from the economic standpoint, it is ready to address conflicts and conclude any given transaction. The first way that power contributes to the transaction is through its direct application by one party upon the other. It must be noted that the power differential is of theoretical interest for development economics as a mechanism to solve conflicts about rules (obviously business model rules, but also intra-elite contest rules) rather than just as a facilitator of specific transactions. Here, bargaining power is the ultimate solution of the non-transaction as it tackles meta-contests, i.e., conflicts about how conflicts are resolved. Conflicts about institutions rely on meta-institutions, i.e., institutions "that wrote the rules by which other institutions changed" (Mokyr & Nye, 2007, p. 55), which are basically intra-elite contest rules (see also the "meta-institutional concepts" of Lorini, 2014, as cited in in Polyakova, Nesterenko, & Sverdlikova, 2019, p. 140). In short, instead of submitting to meta-institutions to unscramble conflicts, including those around institutional change, the second and more expeditious way to conclude the transaction is by leveraging the power differentials across elite coalitions.

In the end, elite agency as leadership is not about closing the transaction, but about securing the business model rules that govern how they are conducted. These include licenses to operate—from monopoly grants to securing property over asset classes like

real estate, data, or the electromagnetic spectrum—and rights over scarce economic resources. Elite business models acquire these scarce licenses by winning not just intra-elite contests (to set 'business model rules' that determine 'who gets what') but also intra-elite meta-contests (contests about the 'intra-elite contest rules' that decide *how* 'who gets what'). Through exercising their power in the political economy, elites are therefore able not just to ink a transaction on favorable terms but also to win the meta-contests that determine standards and intra-elite contest wins. Elite agency seeks to enable value creation and appropriation and so the neoclassical notion of scarcity (applied to rules) explains the recourse to power in all intra-elite contest types. That is, power is also a meta-contest resolution mechanism that functions in parallel with but independently of institutional processes as it shapes the fundamental arrangements that govern the rules of institutional change.

As examined in Proposition 8, high levels of bargaining power are visible in (higher) prices received or (lower) costs paid (Figure 2.2). All power domains—politics ('might'), economy ('money'), and society ('mind')—resolve transactions at the principal-stakeholder level. More strategically, the power of elites resolves meta-contests about the rules that govern institutional change, for instance, those that determine the allocation of rights, whether for natural resource concessions, the setting of minimum wages, oligopoly rents, agricultural and interest rate subsidies, and, of course, any of the so called 'licenses to steal'. Power is, in summary, a key allocative criterion that resolves scarcity (or artificially creates it, as Bastiat explains in *Economic Sophisms*, 1845/1996) in its capacity as a meta-contest resolution mechanism. For Foucault, power trumps institutions as: "one must analyze institutions from the standpoint of power relations, rather than vice versa" (1982, p. 791). As a result, power will work directly in a specific transaction but is far more essential as a shaper of meta-institutions and intra-elite contest rules, since it seeks to determine the business model rules that enable the appropriation of residual income.

4.3.3 Power differentials move institutions and the economy

This sub-section distils the essence of the discussion on power up to this point and stresses its significance for development. Power, with its meta-contest resolution capabilities, is first treated as a value-free outcome of elite coordination and business model leadership in the employ of elite business models and their respective sustainable value creation positions. Hence, the notion that elites necessarily "control" institutions (Mills, as cited in Bell, 1958, p. 239) through the capacity afforded by 'the extraordinary lever' is immaterial and perilously close to the elite populist fallacy ('elites are bad'). The relevant 'power question' for the ETED is *how* elite business models (e.g., those of the East India Company, John D. Rockefeller, the House of Saud, the *chaebol* or OpenAI) accumulate power to defeat rivals in intra-elite contests. Special attention is merited when power relations may be about to be radically altered:

> My work at OpenAI reminds me every day about the magnitude of the socioeconomic change that is coming sooner than most people believe. Software that can think and learn will do more and more of the work that people now do. Even more power will shift from labor to capital. If public policy doesn't adapt accordingly, most people will end up worse off than they are today. (Altman, 2021)

The key point that Sam Altman makes—the acceleration of the shift of power from labor to capital—is a non-issue for elite coalitions, and despite being in the public eye is rarely addressed in advanced political economies with actual institutional change (though Gates proposes the taxing of robots, see Michel, 2023).[70] The ultimate consequence of an AI-induced rebalancing of power from *multiple* elite coalitions to just *one* goes far beyond the displacement of labor and has massive implications. This novel redistribution of power is depicted in 'the absolute lever' of the AI (see Figures A5.3c and A5.3d and the discussion in Sections 8.1.3, 8.1.6, and the Epilogue). Whether or not the once powerful elites of the automotive industry or the military-industrial complex would have to outsource much of their decision-making and operations to the superior intelligence, their value appropriation models would become reliant on the "software that can think" and the terms of service of the AI coalitions. The notion of 'the extraordinary lever' transitions from power belonging to a few in each of the many nooks and crannies of the economy, to 'the absolute lever', held by only a few in the entire political economy. Practitioners know that "technology" is power that affords the "ability to coordinate in groups of unrestricted size" (Suleyman & Bhaskar, 2023, p. 96). More concretely, it also explains why RentPage's "algorithms and artificial intelligence" have succeeded in coordinating price-fixing by large landlords and "changed market structures across the economy" causing rents to increase by 30% in just two years (Stoller, 2024). Later in this inquiry, the capacity of technology to bring the Will to Power that is intrinsic to life and development to a radical ultimate realization is reviewed.

Previous sections have made clear that the accumulation of elite power is a pursuit for preferred institutional change that is more intentional, purposeful, and concentrated than the agency of non-elites (which is a factor in conceptualizing elite agency as antecedent of institutional change). The realization of the Will to Power (the *Wille zur Macht* element in the first principles of the speculative philosophy of this work's paradigm, see Section 8.3.3, Figure 8.6) in all of its Nietzschean force invariably emerges in elites because business model rules enabled by institutions are

70 The elite agency of organized labor has decayed in most advanced economies. For many decades it has shortsightedly focused on concerns like wage levels rather than on strategic approaches to the relevant intra-elite contests of the age. Meanwhile, in value creation terms, the ever-more capable managerial, technical, and creative class (see Figure 8.1) has benefited from its service and closeness to elite business models, while ceding its own autonomous voice and agency in the political economy. AI could reveal this to be a fatal flaw if it ends up delivering a blow to the value creation and appropriation prospects of this class (e.g., see Eloundou, Manning, Mishkin, & Rock, 2023).

existential to them: the rules of the game determine the flows of residual income and the very preservation of elite status (see Proposition 6 on elite identity). Agency with concentrated Olsonian preferences can be assumed to have the stronger action bias over both pragmatic institutions (which represent interests that are more diluted) and organic institutions (anchored in tradition or history), both with unclear ownership and thus more liable to 'capture' (in reference to Stigler, 1971). How power differentials lead to institutional change is described below:

> There will be a conflict of interest over the choice of economic institutions. In such a situation it will be the distribution of political power in society that determines what institutions are chosen. The group with more political power will tend to secure the set of economic institutions that it prefers. (Robinson 2010, pp. 5–6)

The distribution of power in the economy (and its consequences) is an extremely intricate and granular affair with highly uncertain system outcomes. It is hard to determine for the observer or even those deep in the thick of intra-elite contests like Altman, who despite seemingly being ahead of his rivals will need exceptional elite business model leadership skills[71] to ultimately prevail. Since the distribution of power resulting from such leadership determines the terms of principal-stakeholder value appropriation, it can be inferred *post facto*, and serves to inform economic analysis. What is clear is that quantifying the power associated with discrete elite coalitions and the impact that it has requires sophisticated approaches. One such approach is the analysis undertaken by Cozzi and Galli (2014, p. 184) on the bargaining power positions of basic researchers vs applied researchers (or developers) in the US after the early 1980s which "show that an increase in the relative bargaining power of basic researchers [upstream innovators] has harmful short-run consequences for economic growth, even though it could be conducive to higher growth in the longer term". At this point, it is useful to revisit the counterfactual world with no power differentials, one that is the opposite of the AI scenario described above (see Table E.2, hypothesis AI_H1), a world where 'the extraordinary lever' is moot.

Going back to Lord Kelvin's energy analogy of an ocean devoid of temperature differentials, the absence of bargaining power differentials sees no movement, no coordination, and no economic and human development. Intriguingly, power is sometimes treated as a dilemma: "the elites must choose between consolidation of their personal power by continuing to resist change or beginning to make necessary sacrifices for their nation at the expense of their own privilege and prestige" (Kim, 1996, p. 342). This quote implies that there is a trade-off for elites between the retention of

71 Altman's remarkable elite coordination leadership skills were spectacularly displayed in a critical few days of November, 2023 when he triumphantly returned to the helm of his coalition as CEO after his board carried out a "secret plan" to "ambush Sam and remove him from power for the good of humanity" (Huet, 2024, 5:26). Challenged by Musk and Meta (Robison, 2024), Trump's second election victory will further test his mettle.

power and elite system transformation. However, this is a false dichotomy. How elites choose the levels of sustainable value creation for their business models is independent from power accumulation. While there are calls for the power of technology elites to be constrained (from academics like Acemoglu & Johnson, 2023, and pundits like Varoufakis, 2021), the innovation and the benefits that they bring scale with power. Again, all power ('money', might', and 'mind') is instrumental for elites to realize their business model preferences, and when they do so these power types associate with one of the two institutional arrangements that Acemoglu and Robinson (2019b, p. 16) describe: "inclusive economic institutions, which create broad-based economic incentives and opportunities, and extractive economic institutions, which do not". Power must be treated as a quantum-like potentiality on institutions—maybe inclusive, maybe extractive—until it associates with the actual sustainable value creation of business models.

This inquiry basically classifies elite systems by how its coalitions employ power on aggregate. In 'The State of the Elite System Framework' for the political economy, national elite systems characterized by high power can be 'enlightened' or 'rentier', while systems with low power are described as being 'competitive' or 'striving' (on account of their respective high or low 'value', see Figure 6.5). Elite power should not be associated with the repression or absence of sustainable value creation. Yet does this inquiry not advocate for equalized bargaining power, and for competitive intra-elite contests under the conditions of a strong elite separation of powers by using The Three-tier Set of Intra-elite Checks and Balances as a premise for inclusive institutional change?

The ETED calls *ceteris paribus* for a high velocity of elite circulation (see Section 1.3.3), meaning that power endowments ought to mirror 'knowledge', the favored Hayekian advantage in intra-elite contests. Knowledge-based power differentials enable elite coalitions with sustainable value creation business models to enact inclusive institutional change. Power is applied coordination capacity (see Figure 5.3) and is as essential for value appropriation as it is for value creation. Moreover, new elites can only overcome the inertia advantage and reactionary challenges from extractive incumbents with power. Power differentials should exist in order for 'the extraordinary lever' to do its job across the value chain, but these ought to be as short lived as the superiority of 'knowledge' is in competitive markets (see Section 2.2.2).

To recap, power, like elites, must circulate and be used in the right way. This goes to the crux of the eternal and formidable balancing act of the political economy: power must quickly dissipate from particular hands, while its accumulation by a coalition—especially if based on 'knowledge'—should be ironed out of the system at the right time: not too soon (an unusual challenge, but real in polities where the elite populist fallacy holds some sway, such as in Germany or even China), or (more commonly) too late. Once in possession of 'the extraordinary lever', elite business model leadership will take risks—at the very minimum as institutional entrepreneurs in intra-elite contests—to amass and then convert the scarce resource of power into re-

sidual income by advancing its preferences for laws and regulations. This power conversion process is the lifeblood of the political economy: without power differentials there are no states, no technology, no social evolution, no civilization, no modernity, and the world is bereft of coordination capacity. Elite coordination leadership accumulates that power in the first place by structuring a coalition of business, political, and knowledge elites, each contributing their power type ('money', 'might', and 'mind') to the business model with wins in their respective contest arenas of the political economy. At the end of the process, accumulated power is converted into residual income/profits—in its most fungible form, 'money'—and can be used beyond the business model at the discretion of its beneficiaries. A supplementary graphic rendition of the overarching role of power in the elite agency microfoundations of institutional change model (building upon Figures 2.1 and 3.2) is provided in Figure 4.4.

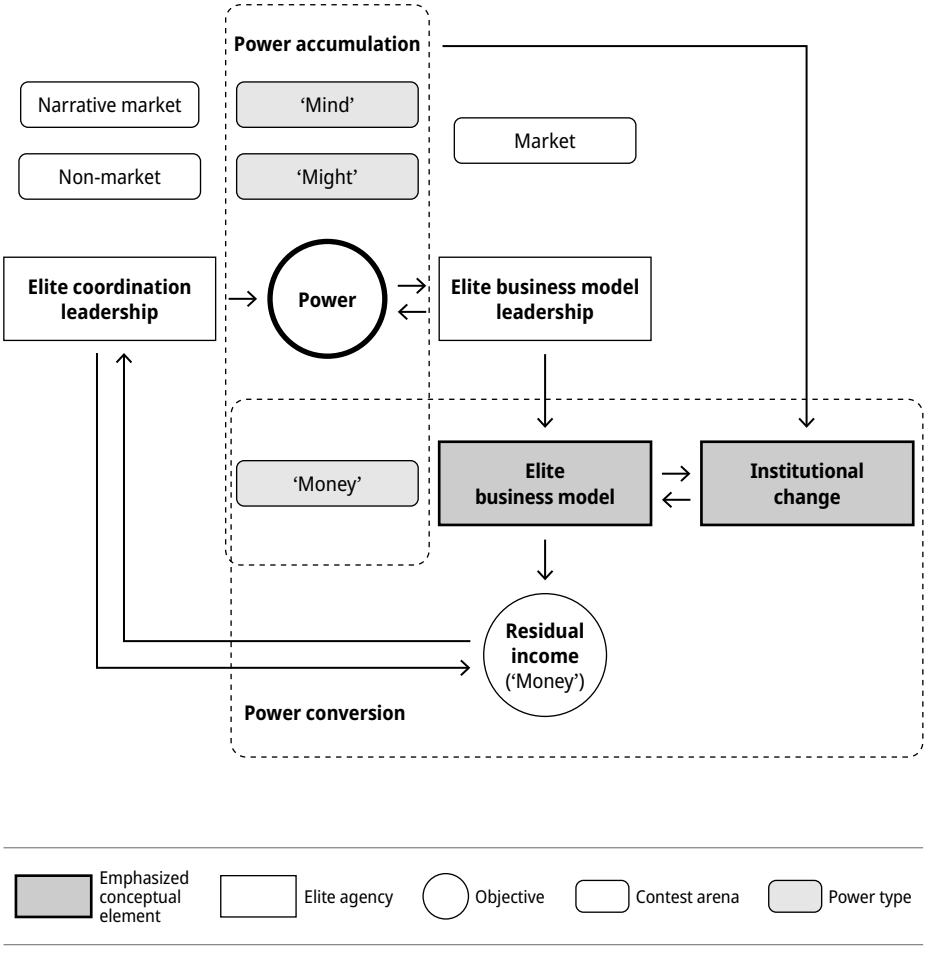

Figure 4.4: The role of power in the elite agency microfoundations of institutional change model.

4.3.4 Power consolidates at elite business model critical junctures

Elite agency is 'institutional entrepreneurship' in the sense that intra-elite contest risks are taken in order to convert power into institutional change consistent with the preferences of specific elite business models (see Figures 3.2, 3.3, and 4.5). As has been discussed, however, the relationship between institutions and elites is often conceived in reverse. That is, institutions and their incentive structures constrain elites. Acemoglu and Robinson (2013a) argue in *Why Nations Fail: The Origins of Power, Prosperity, and Poverty* that the business models of Bill Gates and Carlos Slim (Mexico's telecoms magnate and wealthiest individual) are a consequence of their country's institutions. The elite theory maintains that Gates, in his antitrust case (United States v. Microsoft Corporation, 253 F.3d 34, D.C. Cir. 2001), and Slim, in building alliances with political elites (Presidents José López Portillo and Miguel de la Madrid), essentially amassed the power endowments to effect institutional change (i.e., to overcome constraints or maintain the propitious non-constraints) put in place by previous elites (on occasion heeding non-elite narrativized preferences). Again, whether in Mexico or the US, institutions are the consequence of elite business models that have won intra-elite contests, rather than vice-versa. Gates himself takes issue with the determinant role of inclusive/extractive institutions in his critical blog review of *Why Nations Fail*:

> The authors [Acemoglu & Robinson, 2013a] believe that political "inclusiveness" must come first, before growth is achievable. Yet, most examples of economic growth in the last 50 years—the Asian miracles of Hong Kong, Korea, Taiwan, and Singapore—took place when their political [sic] tended more toward exclusiveness. (Gates, 2013)

Acemoglu, Johnson, Robinson and Yared (2009) dispute the modernization hypothesis (Lipset, 1959; see Section 5.1.1.) where per capita income gains cause increased democracy, more inclusive institutions, and the prosperity that is correlated with it. In their terse response to Gates, Acemoglu and Robinson (2013b) emphasize an alternative "critical junctures" hypothesis of growth (Acemoglu & Robinson, 2013a), and note that "extractive growth doesn't automatically lead to more inclusive institutions", especially when such growth is the consequence of "leaders and dominant elites' belief in their relative security". Their main corollary is "that ambitious entrepreneurs like Gates or Slim will do good for society if inclusive institutions constrain them, and that they will mostly serve their own interests otherwise".

What then happens if the critical juncture sees an intra-elite contest regulated by inclusive institutions with teeth? Lizzeri and Persico demonstrate that during Britain's "Age of Reform", institutionalized "divisions within the elite" led to the democratic "model of voluntary franchise extension" which materialized in "public education" and "urban public goods, particularly public health infrastructure such as sewerage, waterworks, and paved roads" (2004, pp. 736, 737, 755), ultimately contributing to development and the rising incomes of the industrial revolution. In the decision of US federal judge Mehta, Google was found to be in violation of US antitrust law (for instance, for using "distribution contracts" that are "exclusionary") to the detriment of Gates' firm that "has invested

$100 billion in search in the last two decades" to earn a paltry US$ 12 billion in revenue (compared to Google's US$ 146 billion) as the "perpetual scale and quality deficit means that Microsoft has no genuine hope of displacing Google" (United States District Court for the District of Columbia, 2024, pp. 6, 207, 236). The court's final remedies and penalties could set in motion a critical juncture affecting Big Tech's monopolistic positions beyond the online search and search advertising industry and constitute proof that the US is a 'competitive' rather than a 'rentier elite system' (Figure 6.5) where institutions are used by inclusive coalitions to constrain value transfers.

Normatively, the need for constraints parallels 'The Elite Business Model Lifecycle' rendered in Figure 4.5 below. This conceptual element references the management life cycle theory of the firm (Mueller, 1972) and incorporates political economy power in order to derive the 'value transfers replace value creation at maturity' conjecture and visualize the 'elite power vs value creation gap' hypothesis (see its normative opposite, the 'equalized bargaining power equilibrium prices' situation in Figure A5.9c). In his seminal work on "The Nature of the Firm", Coase states that: "a firm will tend to expand until the costs of organising an extra transaction within the firm become equal to the costs of carrying out the same transaction by means of an exchange on the open market or the costs of organising in another firm" (1937, p. 395). The ETED claims that a firm grows to the degree that its political economy power enables value appropriated but *not* created (i.e., allows it to rent-seek), doubtlessly a different kind of efficiency.

The sequence inherent to elite agency starts with emerging models that possess little power, their residual incomes originating from pure value creation. As value is created, power is also amassed, but at a slower temporal pace, meaning that these new sustainable business models (with high VCr scores) are inclusive, contributing substantial transfer-OUT to society. Then, as the new elites become embedded in the national system, their bargaining power grows, increasingly breaking free from institutional constraints. The pace of the increase in their power at this point surpasses that of their value creation. All models, organizations, and people age, and as this happens value creation declines and eventually approaches zero. Elite business models in the latter stages of this lifecycle prevail because they have switched to maximizing transfer-IN and become vested interests that have institutionally consolidated (see lobbying, Section 1.2.2). All elite business models, whether operating in the fields of coalmining, arms, railways, pharma, or search engines, will follow this natural value creation lifecycle and gradually cease creating value irrespective of how much they generated in their heyday. Cory Doctorow (2024a) conceives of "enshittification": "first, platforms are good to their users. Then they abuse their users to make things better for their business customers. Finally, they abuse those business customers to claw back all the value for themselves. Then, there is a fourth stage: they die." The problem is that elite business models don't die or easily go bankrupt when their time has come. Instead, they are able to conserve power even with extremely low sustainable value creation positions and general mismanagement when the elite system fails to engage in weighted structural reforms (see the renditions of The Elite Business Model Lifecycle in Figure A5.9a). The 'elite vs non-elite knowledge creation gap' hypothesis may

also kick in as part of 'the Amazon dilemma' outlined in Section 2.2.2.[72] If it does not, it is more probable that the natural cycle of life dictates that these models gently slip away or are creatively destroyed in Schumpeterian fashion, opening the door for more innovative new entrants. Still, in some cases, the granting of power within the political economy, usually in the non-market and narrative market arenas, enables zombie models to resist (Fernandez & Rodrik, 1991), sucking negative entropy and continuing to appropriate value from the living long after they have ceased to create it.

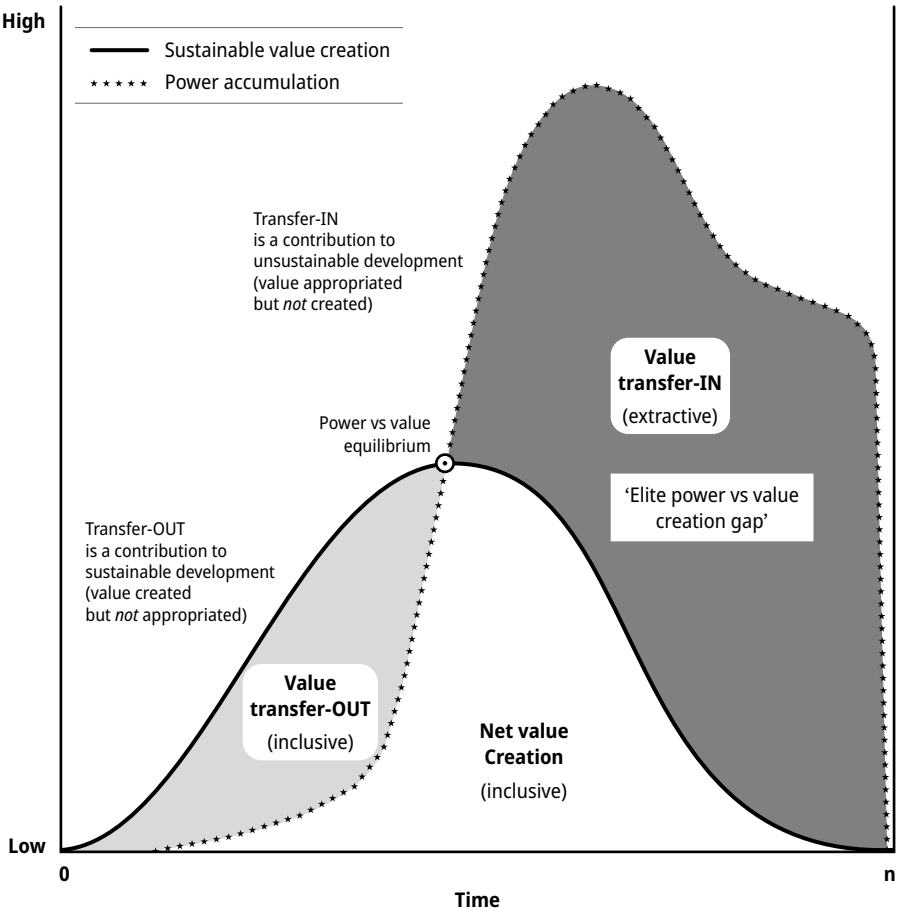

Figure 4.5: The Elite Business Model Lifecycle: The 'value transfers replace value creation at maturity' conjecture and the 'elite power vs value creation gap' hypothesis.

72 Judge Mehta's findings that "In truth, Google's penchant for innovation is consistent with the behavior of a monopolist" provide an apt explanation of 'the Amazon dilemma' which in essence causes a "perpetual scale and quality deficit" (United States District Court for the District of Columbia, 2024, pp. 236, 251) for the totality of stakeholders in society.

The liability of value transfer models cannot be tackled wholesale but must be politically and institutionally targeted and weighted on a case-by-case basis. When extraction becomes unbearable for one set of stakeholders, the business model finds itself at a turning point: it can continue to pursue extraction or instigate a transformation process. The 'value transfers replace value creation at maturity' conjecture means that if an excessive number of zombie elite models agglomerate in the final stages of their lifecycles (as in Figure 4.5), the political economy will itself enter a critical juncture. The depiction of the political economy referencing Elite Business Model Lifecycle scenarios in Figure A5.9a shows two possible paths at such a critical juncture: (a) weighted structural reform with elite bargains that (i) incentivize value and (ii) equalize bargaining power differentials resulting in recovery and increased sustainable value creation; and (b) failed reform or inaction with the consequent collapse of first-order productive activities and ultimately of accumulated power. As elite models agglomerate, the critical juncture reform dilemma applies both to industries and, consequentially, to nations. Failed structural reform (the inability to change elite business model rules) is a turning point where institutions are left to ossify and their constraints become moot, while intra-elite contests degrade and a regressive development path is *de facto* embarked on (both domestically, and, in the case of great powers, with cross-border impacts, see Section 7.3.3). Transformational leadership by individual principals inside the system notwithstanding, elite system leadership (see Table 7.2) must—through interventions in intra-elite contests—implement weighted structural reforms to incentivize value creation and equalize power and value levels (resulting in the pattern of Figure A5.9b).

This chapter has already spent time considering the constraints on elites (i.e., other elites), and now delves deeper into critical junctures. David sees path dependency where "one damn thing follows another", and it is "historical accidents" and remote "chance elements rather than systematic forces" that cause economic change (1985, p. 332). Acemoglu's "directed technical change" and "state dependence" (2002) narrowly deals with the locking-in effects of technology and investment choices on economic outcomes. The scope of historical institutionalism departs from earlier "structural explanations of historical outcomes" and is usually broader, advancing "critical junctures in which actors chose between institutional alternatives, which in turn led to path dependence" (Weyland, 2008, p. 281). What is clear is that "Junctures are 'critical' because they place institutional arrangements on paths or trajectories, which are then very difficult to alter" (Pierson, 2004, p. 135, cited in Capoccia & Kelemen, 2007, p. 342). Libecap's notion of "institutional path dependence" (2011) and the critical junctures hypothesis both see "historical factors" behind the "divergent political and economic development paths of various societies" (Acemoglu, Johnson, Robinson & Yared, 2009, p. 1057). Be as this may, to this inquiry what changes before and after a critical juncture is the amount of power needed by elites to effect institutional change, i.e., how the balance of power between the contestants—often the old and the new—has shifted.

Analysis of the "circumstances under which institutions are—and are not—subject to self-reinforcing 'lock-in'" (Mahoney & Thelen, 2010, p. 3) has not emphasized

elite business models. While Pierson injects an economic rationale to path dependency, his "basic logic of increasing returns processes" is technically a combination of volition and decision rules with accident and randomness in Pólya urn fashion (2000, p. 253) more than the concentrated agency of elite business models. The ETED, as discussed, sees elites constrained by the agency of other elites materializing into cumulative institutional change. At the same time, a critical junctures hypothesis where one-off power differentials between elite contestants lead to developmental tipping points is a further reference for a theory of elites.

This work proposes that long-range developmental critical junctures result from a critical mass of wins in intra-elite contests by a coalition or an alliance of coalitions made possible by their attainment of a power differential during a singular window in time. As winning elite business models subsequently agglomerate, they not only contribute to cumulative institutional change but also, due to their augmented power, cause tipping point institutional change that yields path dependency. Examples of powerful elite coalitions that determined the development paths of nations are numerous: the Soviet Union's military-industrial complex, Germany's automotive industry and its stellar small and medium-sized enterprise (SME) ecosystems, America's private equity (PE), venture capital (VC) and finance industries, Cameroon's Customs Administration (Cantens, 2010), Spain's tourism and construction sectors, and Brazil's agribusiness. At elite business model critical junctures, new dominant coalitions regularly emerge from an elite bargain. In Indonesia, "Soeharto's New Order regime clearly brought considerable material benefits to the majority of the population", with Madame Tien Soeharto promoting specific business models that brought growth and poverty reduction while at the same time receiving a slice of state contracts and thus earning the moniker, "Madam Ten Percent"[73] (McLeod, 2000, pp. 99, 101; Dercon, 2022).

The critical junctures hypothesis in this work suggests that turning points can often be traced to the time when specific business models became those of the core elite coalition as a result of an intra-elite contest (see Figure 8.1). Moreover, because of the weight that they have in the economy, the sustainable value creation positions that they hold have a disproportionate effect on the quality of institutions and the economic and human developmental path of the nation. Which coalition amasses the most power and prevails in a critical juncture might be random (as suggested by David, 1985, and partially by Pierson, 2000), but once 'the extraordinary lever' is in

73 In contrast, the wealth and power amassed by Asif Zardari in Pakistan, also given the "Mr. Ten Percent" nickname by his political opponents (Lingelbach & Rodríguez Guerra, 2023), was not part of an elite bargain for growth with the government led by his late wife, Benazir Bhutto (the country's only female prime minister), or the one he presided over after her assassination. The presence or absence of bargains and inclusive tipping points in fractionalized elite systems explains divergent economic trajectories, in this case between the two most populous Muslim countries. Despite being at similar levels at the turn of the century, Indonesia's GDP per capita is now close to USD 5,000, over three times that of Pakistan (The World Bank, n.d.-c).

the hands of the winner, the subsequent growth trajectory is not (i.e., what follows after the juncture point is 'less' random, while there is *always* elite agency and the potential for transformational leadership). The developmental trajectories of nations consolidate as power trickles down in support of the preeminent models to ever-smaller nooks and crannies in the political economy on the back of institutional change caused by winning coalitions. In parallel to the development paths of nations, emerging core elite coalitions affect the development trajectories of specific industries as the example below illustrates:

> Tesla's no-dealership model now is being adopted by other electric-vehicle startups such as Rivian Automotive and Lucid Group Inc. These fledgling firms, backed by heavyweights such as Amazon.com Inc., are lobbying to change dealer-franchise laws in many states so they also can sell vehicles directly to shoppers. (Naughton, 2021)

In summary, the "composition of de facto and de jure power in society will determine which economic institutions arise" (Robinson, 2010, p. 6). In the ETED, power accrues from intra-elite contests, and the power of rivals is a greater constraint on elites than either institutions or the agency of non-elites. It is the degree of sustainable value creation by the elite coalitions driving critical junctures that determines whether institutional change will be inclusive or extractive. Winning elites will later employ their power differentials to maintain institutional arrangements (a form of institutional change) and preserve their business models, thereby causing development paths to persist. This was the case in 19th century Austria, in post-colonial Latin American states, or, more contemporaneously, in Germany (see Keese, 2017). The 'elite business model critical junctures' conjecture refers to a traceable point in time where a critical mass of power was attained by one or more elite coalitions that achieved economies of agglomeration[74] around certain business models, typically including the 'national business model' that is often run by the core coalition and its constituents.[75] At the

74 The term "agglomeration economies" comes from economic geography, and has been linked to wage premiums or productivity boosts, "where cities and clusters of activity boost the productivity of firms located within them" (Duranton & Kerr, 2015, p. 2). It is not to be confused with 'elite business model agglomeration' as used in this theory. Here, agglomeration refers to the clustering of specific elite business models, the impact of which is only positive if it associates with high sustainable value creation.

75 Firms are characterized by their choice of business models. The patterns that are available to them are recounted in Gassmann, Frankenberger, and Sauer (2016). Likewise, at the macro level, the elite systems of polities and nations, both ancient and modern, are a recombination of business model patterns whose dominant expressions are often easily recognizable by the layperson: the conquer and tax model of the Roman Empire; the theft model of "young Mexican shepherds to tend the vast herds of horses they had also stolen" from American Southwest Comanches (Cameron, 2016, p. 7); what *The Financial Times* has designated as contemporary Germany's "broken business model" of high quality manufacturing exports, a cheap euro, energy imports, and dependency on China and Russia (Chazan & Nilsson, 2022); Russia's oil and gas business model (van den Beukel & van Geuns, 2021), unendurable for large nations aspiring to advanced economy status; the Swiss model of free trade and investment,

'juncture', some models become preeminent, while others invariably become disadvantaged, with the winners able to double down on their institutional preferences and so determine the grand development trajectory of the nation, elite circulation notwithstanding. The conjecture is further explored from an economic development perspective in Section 5.1.1.

4.3.5 Elite business model driven institutional change is endogenous

Chapter 4 closes with a required final disquisition on institutionalism and the endogeneity of power-supported, elite-driven institutional change that extends the ideas developed in Section 4.2.4. Romer's seminal paper on endogenous technological change premises its appearance to the "intentional actions taken by people who respond to market incentives" (1990, p. S72). Kingston and Caballero (2009, p. 166) refer to Ayres' position on "exogenous technological progress as the main driver of institutional change: technological development forces change upon the institutional structure by changing the material setting in which it operates (1944, p. 187)". Technological or otherwise, the nature of the source of institutional change—whether it is endogenous or exogenous—is at the core of a theoretical debate:

> On one hand, the bread-and-butter theorem of neo-institutionalists—the "punctuated equilibrium" (Krasner 1984, p. 226) of path dependency and critical juncture (Arthur 1994; Capoccia & Kelemen 2007; Collier & Collier 1991; Pierson 2000)—emphasize sudden and exogenously induced change. On the other hand, a powerful recent critique of this approach to understanding change has taken a markedly different perspective by outlining gradual processes that slowly undermine institutional substance. The main drivers for this type of change are not seen as exogenous shocks but rather in terms of incremental endogenous developments (Bernhard 2015; Mahoney & Thelen 2010; Weyland 2008). These two poles of exogenous rupture versus endogenous gradual change dominate current research and mark opposite ends of a continuum in explaining institutional change. (Gerschewski, 2021, p. 218)

Let us address the endogenous vs exogenous question and its attendant disruptive vs continuous implication with an example that refers to the earlier discussion on critical junctures. Spain's development path was not marked by the loss of the institutions of democracy after the Civil War (1936–39), but the new regime's technocratic *desar-*

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a strong currency, and MNEs coupled with competitive SMEs; the model of the US dollar "as an international public good" and the ensuing trade (and fiscal) deficits of "Triffin's dilemma" (Bordo & McCauley, 2017) coupled with the innovation leadership of post-WWII America. The 'national business model' refers to the value creation and appropriation patterns, i.e., the "recombination of patterns" (again, like firms, as in Gassmann, Frankenberger, & Sauer, 2016, p. 19) found in the agglomerated elite models of dominant industries, along with their specific set of institutional, economic, political, and social characteristics. From an economic development perspective, the degree of sustainable value creation embedded in the patterns of the national business model is its critical feature.

rollismo bets on industry, tourism, and infrastructure in the 1960s. The critical juncture, or most institutional change for that matter, is not "sudden and exogenously induced" (Gerschewski, 2021, p. 218). It is instead endogenous, and either gradual, where institutional change accumulates driven by elite business model preferences until a critical mass—a point of no return—is reached, or sudden, where transformational (or regressive) leadership comes to the fore (the inscrutable and creative decision-making of leaders accounts for unpredictability and uncertainty in the political economy). Eventually, even suddenly materializing inflection points result in elite models that agglomerate and consolidate, setting the country on long development trajectories of one kind or the other.

In a similar vein, should the credit for Korea's prosperity go the inclusive political institutions that emerged from the 1987 democracy protests, or to the business models of the *chaebol* and their attendant rules endogenously developed during General Park's tenure? Likewise, the extent to which the country's development trajectory was inclusively adjusted by the advent of democracy and the painful IMF reforms a decade later that penalized the family business conglomerates that had become unsustainable value destroyers remains a matter of debate. Transformational leadership was nonetheless evident during the 1997–98 Korean financial crisis when the "massive corporate failures served as credible signals that the government's implicit guarantee regime had indeed ended". As a result, 14 out of the 30 largest *chaebols* basically went "bankrupt or entered into out-of-court workouts by the end of 1999" (Kim, 2006, p. 17) and the country continued with its economic ascent.

The exceptional emergence of Kim Beom-soo ("Born to parents who did not study beyond elementary school, Mr Kim grew up in poverty", Song, 2015), the founder of KakaoTalk and KakaoBank and once "the country's richest man with a fortune of about $13.5bn [. . .] richer than Samsung's jailed leader Lee Jae-yong, whose net worth is $12.6bn" (Song, 2021) may, despite his subsequent arrest and partial downfall (Song, 2024), constitute elite circulation of the admixture type (see Figure 1.1, The Elite Circulation Matrix). Nations benefit when new elites rise up within the system by endogenously amassing power (in the form of 'money', 'might', or 'mind') through novel business models that, as they agglomerate, reconfigure the economy on new trajectories. Certain leaders appear at times to lead this process either with a new business model or by destroying an existing one—sometimes even their previously inclusive own—for its lack of sustainable value creation. In the latter case, in *The Man Who Broke Capitalism*, Gelles (2022) discusses the 1980s and 1990s corporate business model in the US that was allegedly undone by the drive for financialization, outsourcing, and M&As by General Electric's celebrity CEO, Jack Welch. Some concrete turning points in an area of the economy, when magnified by the agency of other coalitions, become elite business model critical junctures that alter the path of economic development. There are also events that are sudden and trigger a track change, as is inclusively exemplified by the Korean financial crash of 1997–98, but are these not exogenous?

Evidently, exogenous shocks such as financial crises, wars, breakthrough discoveries, unexpected political non-market outcomes, or pandemics, are game changers. However, as they occur, time-honored mechanisms usually kick-in and the shocks are absorbed and endogenized (sometimes calmly and smartly, sometimes not) by the current elites while they are invariably integrated into the system. Exogenous shock absorption in the political economy occurs via existing intra-elite contests, endogenous institutional change and, at times, elite circulation. Exogenous events are a factor in on-going intra-elite contests with the winners proving themselves to be more adept at aligning their interests and business model rule preferences with the ramifications of the particular (and ultimately, from an elite perspective, not so shocking) shock. The emergence of applied AI with the launch of the ChatGPT 3.5 model in November, 2022, the Russian war in Ukraine, COVID-19, Trump's November 2016 election victory, and the 2008 Great Recession are all decidedly unexpected exogenous shocks that have been duly endogenized by capable elite coalitions, i.e., digested and integrated into their business models. It is very rare for the elite system and its absorptive mechanisms to collapse, and only in extreme cases, such as the second Taliban takeover of Afghanistan, the October Russian Revolution, or the conquest of the Aztec Empire following the Spanish-Aztec War (1519–21) is institutional change exogenous. The power grabs of the Nazi political elites in Germany and the military elites in Japan were quickly endogenized, with the offending elements extirpated by the victors and local elites in the successful post-World War II development trajectories of post-Nuremberg Germany and post-MacArthur Japan. Selective purges of individual elite members and changes to the dominance enjoyed by specific elite coalitions were a part of this process:

> In Germany, Hitler had done away with independent unions as well as all other dissenting groups, whereas the Allies, through measures such as the decartelization decrees of 1947 and denazification programs, had emasculated cartels and organizations with right-wing backgrounds. In Japan, the militaristic regime had kept down left-wing organizations, and the Supreme Commander of the Allied Power imposed the antimonopoly law of 1947 and purged many hundreds of officers of zaibatsu and other organizations for their wartime activities. (Olson, 1982, p. 76)

The two successive shocks that both countries underwent preserved the elite system but led to the elite business model reconfigurations recounted above, all seemingly exogenous. All four of them (including Hitler's horrific *Machtergreifung* and the meteoric rise of some of his henchmen from non-elite to elite status),[76] point to the endogeneity of the

76 "The alliance of Junkers and industrialists with Brown fascism" led to admixture elite circulation as was obvious to clear-eyed observers like Brown (1934, p. 670), a stance validated, Reichswerke Hermann Göring aside, by the fact that there were "hardly any nationalizations of private firms during the Third Reich" (Buchheim & Scherner, 2006, p. 391). Yet even in admixture mode, new elites can bring their non-elite input, now embedded in winning narratives (see Figure 3.5) to bear. While the 'universal propensity to extraction' assumption (Section 3.3.3) places the morality of elites and non-elites on the same plane, the criminal excesses of the new elites of non-elite extraction in the Third Reich or Stalin's Soviet Union would seem to align with Aristotle's normative position that elites

processes at play and to the absorptive capacity of the system's elite circulation (see Proposition 2).[77] Especially revealing of the endogenization of the exogenous is the rapid post-war economic success of the two countries as a result of exogenous institutional change: many of the incumbent elite coalitions survived and drove inclusive elite business models and genuine elite system transformation.

Established elites, even if defeated in war, usually possess higher accumulated power endowments and coordination capacity in their political economy than alternative coalitions. The Japanese and German miracles are not about Sony or Kyocera, but about the successful transformation of incumbents like the Mitsubishi Group or Panasonic Corporation; not about Otto Verlag or SAP, but about the transformation of BMW or Thyssenkrupp. In The Elite Circulation Matrix terms (Figure 1.1), Japan and Germany saw an exemplary post-war admixture elite circulation mode where relatively high value creation elite business models combined with a respectable level of social order access. However, over the ensuing decades, circulation slowed down, social mobility at the top stalled, and without critical junctures driven by elite agglomeration around innovative new development trajectories (such as the one started by the breakup of AT&T in the US, see Sections 1.3.2 and 7.1.3), opportunities were missed. The once prosperous incumbent models created less and less value and resulted, from the 1990s onwards, in the two countries becoming increasingly detached from the global technology frontier.

Political economies where the speed of business model transformation is not higher than the rate of institutional change see few emerging elite coalitions pushing for the opening up of the novel institutional spaces enabled by technological breakthroughs. Elite business models can be more persistent than elites in the flesh. Exogenous events like new technologies can result in new business models *and* coalitions, but inertia-breaking dynamics necessitate rigorous transformational leadership. Portions of elite power and the coordination capacity of incumbent coalitions must dissolve. Korea's bounce back from the 1997–98 crisis entailed eliminating half of its *chaebol* and, as Johnson (2009) coldly notes, "If the IMF's staff could speak freely about the U.S., it would tell us what it tells all countries in this situation: recovery will fail unless we break the financial oligarchy that is blocking essential reform". The elite system is preserved while its power endowments are reshuffled. Wholesale exogeneous elite replacement processes do take place (e.g., in many post-Soviet states),

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should be born and trained to take on this role, as is the case with an aristocracy or Pareto's "best". It is worth reemphasizing that throughout history non-elites have shown that they can more than outdo their previous masters when it comes to the worst forms of value extraction.

77 For Germany, details are provided in DeJong's *Nazi Billionaires: The Dark History of Germany's Wealthiest Dynasties* (2022). For Japan, note the following citation and its nuance: "The Zaibatsu have steadily built their power and have revived. No, more than that. Before the war, the Zaibatsu had to share their hegemony with large landowners and were under the Emperor and the militarists, but now there are no militarists or large landowners. The Emperor, too, has become an accessory. The power of Japan now rests squarely in the hands of the Zaibatsu, the sponsors of the Conservative Party" (Nagasu, 1959, p. 118, as cited in Yamamura, 1964, p. 539).

but occurrences where the elite system and most elite coalition sub-systems disappear are rare (as discussed in Section 3.3.2). The ideal admixture elite circulation mode suggested throughout this work (e.g., Wall Street's handholding of loss-making Amazon on its path to core elite coalition status) is fundamentally endogenous.

This section has surmised about the endogenous nature of elite business model driven institutional change. In economic models, the distinction between endogenous and exogenous variables is critical, but by establishing the endogenization of the exogenous, this distinction loses relevance. Furthermore, such a distinction is already redundant if endogenous events are embedded in a complex system and characterized by their randomness, non-linearity, emergence, and evolution, as in systems theory (see Section 3.2.3): endogenous and exogenous events might receive a different mathematical treatment in models, but their properties and patterns resemble each other in a complex system. The infection and fatality rates of a novel virus' mutations, or a foreign leader's decision to start a war, are exogenous events, yet there is minimal practical difference between their impact on elite business models and the similarly unpredictable and endogenous emergence of the AI or which firms will win the intra-elite race for its value appropriation. The most consequential variables in the economy for the purposes of growth are not so on account of whether they originate inside or outside the system, but rather because of their non-repeating, unpredictable, emergent, chaotic, and high-impact nature. Grasping the patterns and behaviors of such variables as they come into existence requires modeling the complex adaptive elite system from which they emerge. This is then not a problem of determining the exogenous or endogenous factors or of projection. Rather, it one of estimating the "range of reasonable possibilities" coupled with the awareness that "forecasts are better viewed as distributions of probabilities than as exact predictions" (Beinhocker, 2006; Liebovitch, 1998; Prigogine, 1996, all cited in McDaniel, Lanham, & Anderson, 2009, pp. 4, 6). The kinds of probabilities that this theory sets out are those associated with inclusive institutional states where sustainable value creation elites have outcompeted their rivals in the arenas of the political economy whose business models lean more extensively on value transfers.

In closing this chapter, a further reflection on the role of power is required. Power is a strategic capability that provides value appropriation options for those that hold it—the elites. Obviously, it can also be used to accomplish much more than simply maintaining extractive transfer-IN models against resistance. Power is considered misused, for instance, when incumbent elites refrain from taking risks, are unable to innovate, and fail to transform their business models to match the speed of general social and technological progress. Power is what provides elites with the options for successful transformation and the absorption of exogenous shocks. If applied effectively it will prevent a solid business model from decaying (à la General Electric) or fading into oblivion (à la Kodak) through new value creation. At the national level, the power and cohesion of the core elite coalition (see Figure 8.1) is the ultimate backstop to prevent a political economy from sinking into an extractive free-for-all that takes a country and its elites down. Such a free-for-all endogenous extractive degener-

ation characterized China's early Republican fragmented elites and feuding warlords after the Xinhai Revolution in 1911–1912, as well as the imperial ruling Confucian narrative-imbued Manchu elite of the late Qing Dynasty. Both powerless and excessively powerful elites can lead to the state of affairs described by Lu Xun, who delved into the analogy of cannibalism in his masterpiece, *A Madman's Diary* (1918/1985).[78]

There is no determinism in power and its use. For instance, powerful elites that have fallen behind their peers in terms of the value creation of their business model can strategically leverage their existing coordination capacity through alliances with new, emerging, and value creating elite coalitions. At the country level, this is what the CPC elites did under Deng when launching their "Socialism with Chinese characteristics" economic reforms on December 18, 1978, or what US elites did in the 1990s by seizing the possibilities of the Internet revolution. This admixture, facilitated, even if not actively promoted by all incumbents, is one of the desirable outcomes enabled by power. One must never forget that degrees of power, like degrees of extraction (see the 'alternating value extraction and creation' conjecture), are necessary for value creation. This appears to fly in the face of 'equalized bargaining power equilibrium prices' (see Section 2.2.2), a contradiction that lingers throughout this inquiry.

Faced with an exogenous or endogenous event with tipping point potential, i.e., able to affect power transitions, how can sustainable and productive admixture prevail over vicious intra-elite contests and civil strife? One might consider the powerful US finance industry and its legally codified rules for venture capital (Armour & Cumming, 2006) that provide the incentive structure for innovation and drive the Bay Area's immense value creation. Such institutional change is in essence a win-win partnership between incumbent and emerging elite coalitions kick-starting new development trajectories that boost economic and human development. It is of little concern to the enlightened self-interest of the establishment that the rising elites they support become wealthier and eventually accumulate more power than their original sponsor. Members of Silicon Valley elite coalitions have now circulated to the apex and bested those of Wall Street[79] by realizing the potential of technology to unlock novel forms of value appropriation, using 'the extraordinary lever' to endogenously double down on institutional change as necessary. These transformations have also been highly advantageous to the legacy coalitions in their role as investors.

78 "It has only just dawned on me that all these years I have been living in a place where for four thousand years human flesh has been eaten". In this poignant passage, Lu Xun (1918/1985, p. 51) points to an extractive terminus, a low point free-for-all where the practice of value extraction has spread to elites and non-elites alike and imbues both culture and institutions.

79 The profits for US Fortune 500 companies in the technology sector reached US$ 306 billion for the fiscal year ending March 31, 2023, while those in the financial sector were less than half of this (US$ 139 billion). See: https://www.growandconvert.com/research/most-profitable-fortune-500-companies-in-2023/

Summary of Chapter 4

Towards elite agency constrained and enabled by power and institutions

Part II of this book ('Integration') seeks to bind its diverse conceptual elements into a coherent theoretical system. This work begins with Chapter 4's exploration of how elite agency is both constrained and enabled by power and institutions. The initial Section 4.1 hones in on the basic building blocks of elite agency in the political economy, the first of these being the leadership required for its success. This behavioral construct is a *leitmotif* of the ETED and the examination details its two fundamental varieties: elite coordination leadership and business model leadership (4.1.1). They respectively relate to the attainment of the two objectives of elite agency in the political economy, power and residual income (see Figure 4.1). Here, the discussions briefly reconvene and (in Table 4.1) the chief conceptual elements for a political economy theory of elites (4.1.2) are recounted.

Section 4.2 consolidates elite agency as the microfoundation of institutional formation and change, a recurring theoretical meeting place in this inquiry. Aiming at the development of a comprehensive institutional perspective (anchored by Proposition 12), the focus of the first sub-section (4.2.1) is on the incentive structures that make specific division of value strategies feasible, thus enabling and constraining residual income and economic growth. A step back is taken in the next sub-section (4.2.2) to explore elite agency through the 'follow the money' *cui bono* heuristic of institutional change. The theory now tightens the connection between these insights to strengthen the idea that the immediate elite preferences for institutional change concern business model rules (see Figure 4.2) with their discrete potential for sustainable value creation. As a result, these rules contain signals of future economic and human development (note the link to the elite quality discussion in Chapter 6). Further grounding for elite agency is then provided (4.2.3) through a review of elite embeddedness, the paradox of agency, and how limitedly structure constrains elites; in reality they are mainly constrained by their peers (or by structures maintained by their peers). Discrete elite conceptualizations of embeddedness for business model and intra-elite contest rules are respectively proposed and the relationship between the two rule types is expounded on (see Figure 4.3). The closing sub-section (4.2.4) then canvasses additional theoretical support and provides historical examples of elite agency by focusing on the differences between spontaneous and deliberate institutional formation and change. The inquiry emphasizes deliberate elite agency that strives to adjust the incentive system in consistency with its business model preferences.

Section 4.3 focuses on power and elite agency. Institutional change is feasible with the accumulation of power through wins in the political economy's three power domains (economy, politics, society) and its associated contest arenas (market, nonmarket, and narrative market) that emanate from elite coordination leadership. The first sub-section (4.3.1) reviews the notion of 'power' and posits that it is everywhere,

inescapable, and, as a facilitator for the formation of a common will and the ability to project it, resolves value appropriation in society. The next sub-section (4.3.2) reviews power as a mechanism for the meta-contest resolution of conflicts and explains how power differentials supersede meta-institutions—basically intra-elite contest rules—at effecting institutional change. Power differentials are essential to move institutions and the economy and the next sub-section (4.3.3) provides a synthesis (Figure 4.5) that considers countervailing emphases like circulation velocity and 'knowledge' as the key source of power. The 'elite business model critical junctures' conjecture, an extension of the critical junctures hypothesis, is then introduced to explain the development trajectories of nations on account of 'elite business model agglomeration' (4.3.4). The underlying logic of The Elite Business Model Lifecycle is rendered in Figure 4.5. Finally, the closing sub-section (4.3.5) takes a position on the critical question of whether institutional change is exogenous or endogenous and stresses the preeminence of endogenization.

There is an unambiguous principle of the political economy: value transfers require power. Extractive political institutions reflect extractive elite business model preferences that are realized through control of 'the extraordinary lever'. As a critical conceptual element of this inquiry's paradigm, power is measured (e.g., it is one of the main components in operationalizing elite quality, see Sections 6.2.2 and 6.2.4). It should also be recalled that power is functional to elite agency. It is not pursued for subtle psychological motives but to generate residual income (see Proposition 6 on elite identity). Yet Arendt's understanding that power is a mechanism to act on behalf of others also stresses its deep ethical quality and potential: it is extant and necessary in society and provides options for inclusive elite business model and elite system transformation on the back of discrete types of leadership.

Having tightened the links around the key theoretical bases, Chapter 5 now aims to establish the first approximation of an elite theory of economic development.