Institutions and Economic Growth: Cautionary Tales from History

*Thought Experiment Lecture**

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Sheilagh Ogilvie

Faculty of Economics

University of Cambridge

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"Learn from history or you're doomed to repeat it." – Really?

As an economist who works on the past, I like to believe that history matters. And there's plenty to learn from the past – especially the crucial eight centuries between 1000 and 1800. But the most important lesson is that history *doesn't* repeat itself.

There are some bits of history that we'd love to repeat. Economic growth took off during the Italian Renaissance, the Dutch Golden Age, and the British Industrial Revolution. These economic miracles put Europe on the path to the wealth and well-being it enjoys today. If we worked out how to repeat this history, it would be marvellous.

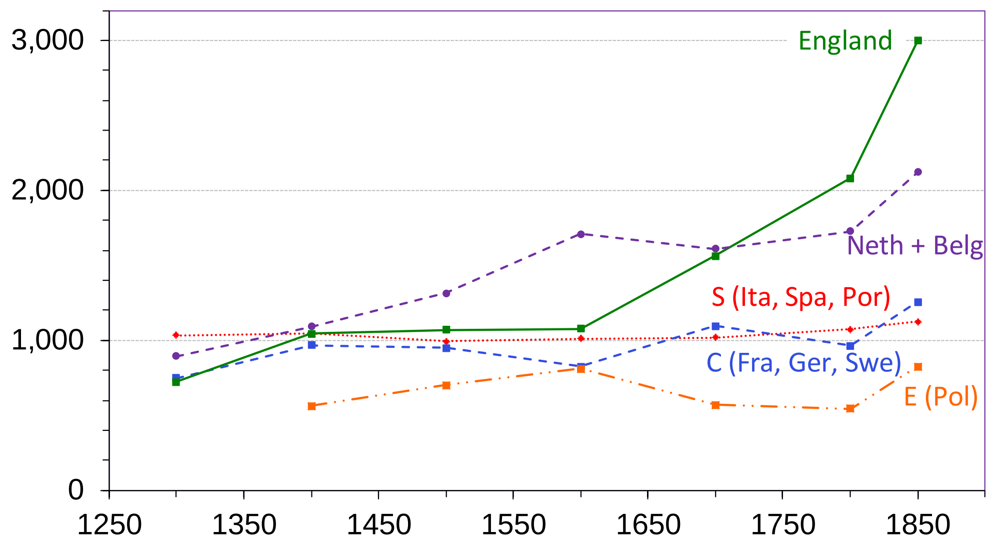
But sadly, it's very tough to repeat history – especially the good bits. I explained why in my Thought Experiment Lecture at HM Treasury on 18 October 2019. I was asked to talk on "Institutions and Economic Growth". But I couldn't resist adding the subtitle, "Cautionary Tales from History".

The Basic Question in Economics

Economists' most important question is this one. Why are some countries rich and others poor? In the medieval period, Europe was a backwater. But by around 1500, it was already growing faster than other continents, in what historians call the "Great Divergence". This was mainly because northwest Europe began to outperform southern, central and eastern Europe – the so-called "Little Divergence". The Low Countries – what are now Belgium, Luxembourg and the Netherlands – experienced stunning economic growth from around 1450 to around

1700. But around 1650, England started growing faster than the rest of northwest Europe. Then, in 1760, England launched the Industrial Revolution and took off into sustained growth – the first economy on the planet to do so.

Per capita GDP ($1990) in Europe, 1300-1850



What caused this economic divergence? One important set of explanations focuses on institutions – "the humanly devised constraints that structure political, economic, and social interaction", in [Doug North's famous definition](). One nice thing about institutions is that they are humanly devised. So they imply that policy matters. Many economists now think that if we can pinpoint the institutions that caused the northwest European economic miracle, we can trigger economic growth in modern poor regions, maybe even whole societies. We make history repeat itself.

My lecture looked at some popular institutional explanations for why England – which in practice meant Wales and Scotland as well – grew fast and industrialized first. I focused on three institutions: state capacity, parliaments, and the western family system. A sober investigation shows that each explanation fails some simple tests. From this, I draw some cautionary lessons about what we can and can't learn from history.

State Capacity – A Two-Edged Sword

"State capacity" is a hot topic right now. Simply put, it refers to the ability of a state to collect taxes, enforce law and order, and implement its policies. Some economists and policymakers argue that state capacity was a major reason England outperformed other European economies after 1650. The English state spurred growth because it protected the economy from external predation, made markets work better, established an effective bureaucracy to provide public goods, enforced an impartial rule of law, and engaged in nation-building which created cultural homogeneity. But does historical evidence support these ideas?

Predation, history shows, is something that states not only repel but create. Many high-capacity European states initiated predation. The key thing about England was that it was lucky enough to stay out of European wars until around 1700, after its economy had started growing and could support a bloated military.

Markets also experience the state as a two-edged sword. Some high-capacity European states did make markets work better by guaranteeing property rights and contract enforcement. But others made them work poorly by imposing trade barriers and granting monopolies to special-interest groups like merchant associations, craft guilds, and powerful landlords.

Bureaucracies can do bad things as well as good ones. The earliest professional bureaucracies in Europe arose in Germany and Scandinavia, whose economies stayed poor and stagnant until after 1800. Economic growth accelerated in the Netherlands in the sixteenth century and in England in the seventeenth, long before they developed modern bureaucracies. How an efficient bureaucracy affects growth depends on what the bureaucracy does. Does it provide public goods like infrastructure, security, justice, education, and welfare? Or does it enforce monopolies and extract bribes?

The rule of law also has two sides. Germany and Sweden had very high legal capacity to enforce trade barriers and monopolies. England, by contrast, had very low legal capacity to do these things, at least before 1800. Which was better? If the law promotes harmful policies, a high-capacity state can enforce those very effectively.

Nation-building and cultural homogeneity also have a dark side. Historically, some culturally homogeneous economies such as Germany and Sweden stagnated. Quite a few heterogeneous ones, such as Britain, Belgium, and Switzerland grew fast. The Netherlands and England welcomed economic migrants from all over Europe in the early modern period, fueling their economic dynamism. Coordinating on a shared national ideology can facilitate social harmony. But it can also fuel external warfare and internal oppression, for instance against Jews, women, or migrants.

On state capacity, the lessons from history are bleak. Having high state capacity will only benefit economic growth if the state does things that are good for growth – and state capacity alone does not guarantee this.

Are Parliaments the Key to Growth?

A popular "lesson from history" is that strong parliaments caused economic growth (North and Weingast 1989, Acemoglu and Robinson 2012). According to this view, in Britain after the Glorious Revolution of 1688, a Parliament manned by "wealth-holders" protected property rights from a rapacious executive, and this made a major contribution to British industrial take-off in the 1760s. The policy implications are clear: modern LDCs can ensure economic growth by setting up strong parliaments.

This argument is very attractive, given the many reasons for believing that parliamentary government is a good thing for its own sake. But does economic history support the idea that strong parliaments are invariably beneficial for growth? Sadly not.

Even in Britain, there is no evidence of any discontinuity in Parliament-Crown relations around 1688 – the "Glorious Revolution" was evolutionary, not revolutionary. There is also no discontinuity in British economic growth around 1688 – the institutional causes for English economic growth must have already been active in 1650 or 1600.

Poland had a very strong parliament from the sixteenth to the nineteenth century. But it represented noble landowners and mainly acted to enforce serfdom, leading to the long stagnation and contraction of the Polish economy.

The southwest German state of Württemberg had a very strong parliament, which was often compared to that of England. But the Württemberg parliament mainly represented urban guildsmen and enforced cartel privileges for merchants and industrialists. This contributed to the long-term stagnation of the Württemberg economy, even by German standards.

The Netherlands had strong parliaments, on both national and provincial level. These co-existed with economic growth during the Dutch Golden Age from 1560 to 1700. But after 1700 Dutch parliaments increasingly enforced privileges for entrenched interest-groups, contributing to economic stagnation and late industrialization.

History shows that in societies where "wealth holders" enjoyed parliamentary representation, they didn't always use it to improve the ease of doing business for everyone. Instead, they often used it to secure institutional privileges to extract rents for themselves, even though it harmed the economy as a whole – a bleak historical health-warning for vibrant modern democracies such as India.

Public institutions are needed for markets to function, and parliaments are an important component of public institutions. But what matters is what parliament *does* with its powers. We need to understand how to repeat the good history of parliaments and not the bad. This means analyzing the entire institutional framework, which decides how wealth holders become wealthy, how they (or others) obtain parliamentary representation, whether parliament passes policies that are good or bad for growth, and how parliamentary decisions are implemented in the real economy.

Did the "Western Family System" Cause Economic Growth?

A final cautionary tale concerns a very different institution – the family. There is a popular argument that the key institution that caused European economic success was the "western family system". This argument focuses on the so-called "European Marriage Pattern", which involved late marriage (age 25-30 for both sexes), high lifetime celibacy (10-20% of people never marrying), and a nuclear-family-based household structure. This family system, it is claimed, favoured economic growth in four ways:

1. The fact that people delayed marriage until they could support themselves independently calibrated fertility and population growth to economic conditions, leading to higher capital accumulation and innovation, and an "escape from Malthus".

2. Late marriage and high celibacy reduced total fertility, thus motivating parents to make a “quantity-quality trade-off”, in which they had fewer children but each child got more education, which then fuelled economic growth.

3. Late marriage and high celibacy meant that women worked in the market and invested in their own skills, which benefited the economy at large.

4. The nuclear-family system generated good norms such as prudence, generalized morality, rule of law, and respect for women, which created the cultural basis for economic growth.

England industrialized first, it is argued, because it had an “extreme” version of this European Marriage Pattern.

If these lessons from history are true, it would imply that people in modern poor economies must change deeply rooted aspects of their private life to achieve economic growth.

But is the European Marriage Pattern indeed why England industrialized? In 2014, Tracy Dennison and I carried out a meta-analysis of 365 demographic studies, comprising 4,705 observations of marriage age, lifetime celibacy rates, and nuclear family prevalence, covering 33 European countries across the four centuries from 1500 to 1900.

We found that England and the Netherlands, the miracle economies of the early modern “Little Divergence”, had very moderate versions of the European Marriage Pattern. The most extreme variants of the European Marriage Pattern were found in Scandinavia, Germany, Austria, and Bohemia – poor and stagnant economies. Moreover, England moved away from the European Marriage Pattern before and during Industrial Revolution: between 1670 and 1810 female marriage age in England fell from 27 to 24 years.

Calibration of fertility to economic conditions was stronger in many other European economies than in England. Educational levels were higher in slow-growing economies such as Germany and Sweden than in fast-growing ones such as England or Flanders. Women's position was not invariably high under extreme versions of the European Marriage Pattern. And there is no concrete evidence that nuclear families created better norms than other family systems.

The "western family system", it turns out, prevailed in a whole range of institutional contexts. In dynamic England and the Netherlands, a moderate variant of the European Marriage Pattern existed in a framework of good property rights, well-functioning markets, and few restrictions on women's work. In central, eastern-central, and nordic Europe, an extreme form of the European Marriage Pattern existed in a framework of intense community, guild, and landlord controls on property rights, labour markets, and innovation, accompanied by low output, slow growth, and late industrialization.

The family is always embedded in a wider system of underlying institutions that shape demographic and economic choices. The institutions needed to sustain the "western family system" were not necessarily the same as those that promoted economic growth. It was the institutional system as a whole, not the family in isolation, that influenced whether an economy grew or stagnated.

Cautionary Tales from History

Historical institutions have become popular in explaining economic growth. But any historical explanation has to do at least three things:

1. establish that Institution X existed only in fast-growing economies;
2. establish that Institution X did only good things;
3. explain why Institution X caused growth in England and not elsewhere.

There *is* an institutional explanation for why the Industrial Revolution happened first in England. However, it doesn't involve looking at particular institutions – state capacity, parliament, the family system – in isolation. Instead, it resides in the whole institutional framework – a variegated system of institutions that checked each other's abuses. What was this interconnected, growth-friendly institutional system? It had three key elements:

1. **Government:** In the early modern period, England and the Netherlands gradually developed an efficient system of taxation and public finance, which enabled the government to stop enforcing the privileges of special-interest groups that harmed economic growth.

2. **Markets:** As a result, markets in England gradually became much less manipulated by special-interest groups. This meant producers could trade with consumers without having to buy off parasites (landlords, guilds, communities, the church) along the way. Markets could allocate land, labour and capital more efficiently, and reward innovators who introduced new products and processes.

3. **Civil society:** England developed a heterogeneous civil society strong enough to monitor and resist attempts to manipulate markets and corrupt governments, but also to exert checks and balances inside civil society itself, preventing any one element – the church, the guilds, local communities, noble landlords – from

dominating all the others and extracting market privileges from governments.

The key to growth was thus no single institution in isolation. Rather, it was a combination of strong governments, strong markets, and a strong civil society. Each component depended on the other two. Each institution also depended on an interconnected web of other institutions that held it in place and checked the inherent vulnerability of any given institution to corruption and abuse by the powerful.

The lesson for growth? Institutions matter. But they matter as systems. So they are hard to transplant. And there are no magic bullets. It is tough to repeat history, especially the good bits. But we can design better policies if we understand why history is so hard to repeat.