Economists tend to be a cynical lot, or at least they can seem so to the general public. Contrary to common perception, your typical academic economist does not believe that only money matters, and self-interest is not equivalent to selfishness. People are as likely to be altruistic as venal, and in day-to-day life, they are probably more likely to exhibit kindness than viciousness. Yet it is always wise to bear in mind that self-interest, even of the more enlightened sort, must be given consideration in any serious analysis of human behavior. And any economic system is bound to fail were it to rely exclusively on “the kindness of strangers.”

Nowhere does cynicism seem more justified and despair more commonplace than when considering the problem of human development throughout history. We often forget how fortunate we are to live in the wealthiest section of the wealthiest era in human history. Indeed, if we abstract away from the last few centuries, we would be justified in feeling that the default state of human civilization is penury. In all but the rarest of cases, total production and consumption were low and only a tiny elite could enjoy access to food, clothing, and transportation that would seem miserly in quantity and/or quality to the vast majority of the citizens of the developed world today. We get some sense of how bad things must have been when we realize that even today, most citizens of the world live on only a few dollars a day, while a substantial minority subsist on less than a dollar a day.

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The fact that a few dozen of the world’s nations seem to have figured out a way to configure their social structure so as to permit, even encourage, productive activity has only made a limited impact on the world’s poorest nations. This has much to do with the ways in which political bargains that were made to assure stability and order prevent the kinds of laws and norms conducive to rapid growth.

Douglass North’s life’s work has taught the entire economics profession to pay close attention to the evolution of the institutions that structure economies and most especially to the way that the state controls and defines property rights. Because of the necessity of maintaining order to limit violence and coercion, we are faced with a fundamental conflict: any ruler strong enough to establish and enforce the rules that underlie a functioning economy is also able to abuse that power for his own benefit. Hence, in the common formulation, the ruling parties are faced with the decision to Make or Take. Thus, the success of the economy is critically dependent on the ability to constrain the ruler’s force so that his promises of secure property rights and market-preserving order are fully credible.

If there were a mechanism to enforce efficient cooperation, human societies should evolve as to promote greater productivity and improved human welfare. But as noted in Nye (1997), the presence of high transactions costs combined with the distributional consequences of those with the power to coerce being unwilling to give up their perquisites suggest that open competition will not necessarily produce a welfare maximizing outcome for all. In his recent work with Wallis and Weingast, North (2009) has decided to treat the problem of force and violence more directly by analyzing how dominant elites band together to provide the privileged with a limited order that constrains conflict and allows the fruits of growth to be shared by them. On the one hand, this is an improvement on the Hobbesian nightmare that typically threatens the primitive order, but on the other hand, the limited competition demanded by the elites prevents the full flourishing of the polity and the economy, strongly constraining growth and welfare.

North, Weingast, and Wallis have identified many of the preconditions that seem to accompany countries that have been able to advance beyond what they call the Natural State to join the successful but rarer group of nations with widespread market competition and dispersed political power. At the end of the day, however, most of us do not really understand why elites ever permit reform.

It is common to discuss the problem of promoting economic development
by referring to so-called failed states. Yet, as North’s choice of the term “Natural State” emphasizes, the constrained order typical of most nations throughout history has strong stability properties rooted in the fact that one usually cannot displace beneficiaries of the existing order without losing the public benefits of that system. Thus the surprise is not that—judged by the standards of the most prosperous nations—nations fail to reform. The surprise is that meaningful reform is ever forthcoming.

Even in cases in which the elite are forced to step aside through revolution, one often observes the phenomenon that the new elites promote rules that are just as restrictive or else the revolutionaries are themselves ousted. This should be natural. To the extent that existing elites in a natural state are in a stable equilibrium, they will have evolved to be specialists in or to have made alliances with specialists in social control and violence. Successful revolutionaries are likely to be just as much specialists in taking rather than making. To the extent that fortuitous circumstances allow the makers to emerge triumphant, their victory will be short-lived unless they can solve the problems of control, which means allying themselves with specialists in force while finding stable ways to restrain them from taking over the state and becoming the new, unconstrained rulers.

Thus, most successful reform usually involves the participation of at least an important subset of the elites. But how is that to come about? This is the agenda that is suggested to us by current work in economic history and the new institutional economics.

To the extent that elites permit reform, it is usually because they cannot derive the benefits they desire without more widespread competition. But the most significant failure probably arises from a group’s inability to preserve its long-term “class” interests.

For example, suppose that the nobility currently benefits from a restricted commercial market. High transactions costs and inefficient commerce preserve local control and monopoly rents. However, opening that market may allow beneficial economic and technological development. To the extent that such a transformation might be helpful to the nation at the expense of the future elites, such changes will take place only if the nation at large can force the current elites to change or to see that it is in their self-interest. Monopolistic elites usually have arranged the social order so that such pressures are neither easy nor advantageous; else the existing state would not have been particularly stable.

Thus, we expect them to cooperate only when they clearly stand to gain from
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The transition. But this is actually much harder to accomplish than would seem at first glance, even in countries that perform so poorly that arguably minor reform would lead to large gains in wealth for both the privileged and the masses. The major reason is that it is almost impossible to coordinate and create a binding agreement that permits the necessary reforms while guaranteeing the elites the maintenance of their political dominance and control. Even where compromises are structured to try to offer such assurances, they are usually less than credible. By its very nature, greater openness encourages innovation and change, which is both unpredictable and likely to affect the balance of power both among the elites and in the relations between the elites and the people at large. Even a modest change in average wealth, let alone the introduction of new markets and technologies, introduces so many uncertainties that preserving the social order while encouraging economic development is not credible. Yet in many ways, those are the “rights” that the privileged are most interested in maintaining.

It is strange that economists talk about the importance of property rights yet do not recognize that the rights that the fortunate are most interested in preserving are the rights to the maintenance of their existing lifestyle. That there are no easy ways to guarantee such rights, or that preserving such rights may be anathema to political liberalism is all the more reason why elites would resist reform and structure the rules to exclude any possibility of overturning the existing order.

Hence, it is often the case that elites commonly permit reform when they are either mistaken about the costs and benefits of a given change, or more commonly when the benefits are such that the current generation of elites—or a critical subset thereof—stands to gain at the expense of future generations. A Marxist might speak of the privileged betraying their class interests.

Yet it is striking that one of the most astute observers of this phenomenon was the great Adam Smith, who noted as much when considering the question of how Britain successfully began the transformation to being a liberal state. This insight was further elaborated on by Mokyr and Nye (2007) in considering what recent research in economic history tells us about the peculiar evolution of the British economy.

Eighteenth-century Britain was a hotbed of rent-seeking and corruption. And yet surprisingly, much of that venality was directed in such a fashion that it helped support an increase in public goods and a gradual, albeit uneven shift towards a more open, more market-oriented economy. Where seventeenth-
century England had been a fragmented nation, rife with religious conflict with a monarch who periodically pushed the state to the edge of bankruptcy and oversaw a patchwork of regional markets that favored a provincial, rural aristocracy, eighteenth-century Britain gradually shifted to a more unified nation, dominated by a strong Parliament, whose elites were devoted both to promoting the public interest as well as enriching themselves. This took the form of improving commerce and navigation to the point where Britain in the late eighteenth century was increasingly an integrated single market and promoting public goods that enhanced commerce at the expense of local monopoly control.

For the Industrial Revolution to be successful, Britain had to overcome the problem of incumbent landed powers who drew their political, social, and economic strength from the existing blend of feudal customs and traditional arrangements. For example, improving landlords and entrepreneurial farmers had opportunities to innovate in agriculture and to re-arrange property rights through enclosures. These opportunities implied in turn that those who where least successful in making such experiments should abandon agriculture at considerable cost. Yet the losers in the process were unable to stop it using either legal or extralegal means. After 1750, the state had chosen sides. Although property rights remained one of the central mantras of Parliamentary rules, many of the activities of the eighteenth century British state “removed, reallocated, and in short, invaded property” (Langford 1991, 146). Property required regulation and enforcement, and in the eighteenth century, decisions were made increasingly on the basis of national interests (Mokyr and Nye 2007).

Market integration and political centralization were the critical characteristics of the British transformation. This led to some odd juxtapositions that belie the simple caricature of liberalism that is sometimes told in describing the British transition to modernity, but that is easier to comprehend when we consider the problem from the perspective of reforming elites. The same Britain that promoted some of the most important liberal reforms in world history was also the scene of one of the most astonishing expansions in the central state. At a time when most nations had difficulty raising government revenues substantially, the liberal British were successful in dramatically raising tax receipts to the point where government revenue grew some 400 percent more than GDP. Moreover, these revenues were mostly spent on foreign wars. Some were undoubtedly defensive, but most were part of a process of British expansion that made their nation the
dominant imperial power on the planet. It is striking to note that Britain was at war for roughly half of the eighteenth century. Scholars still do not understand what the costs and benefits of these wars were to the British economy. But it is almost certainly the case that such expansionism did not lead to the imperial bonanza that is sometimes claimed (cf. Huttenback and Davis 1987 for a sobering look at the true cost of empire). However, it is also the case that we cannot say for certain if—in practice—there had existed a more efficient and politically viable mechanism for protecting British interests and defending the realm. The ability to properly wage war is an essential element of a successful economy in a hostile world, and the right benchmark may not be limited and efficient warfare but a comparison between fighting “inefficiently” and wastefully versus having neither the structure, the will, nor the fiscal capacity to engage in armed conflict at all. All this is mere speculation at this point, but there can be no doubt—especially given the thrust of the recent work of North, Wallis, and Weingast—that institutional scholars will have to come to grips with the problem of armed conflict and the necessity of state control—warts and all—of the military. At any rate, the British somehow managed to hold off the dominant French, who were, by virtue of successful history and a much larger population, often regarded as the leading European military power.

Similarly, it is not well known that Britain did not become the paragon of free trade told to us in our history books till the very end of the nineteenth century. Recent work has demonstrated clearly that Britain still clung to many of the most important eighteenth-century mercantile tariffs that Adam Smith had damned in the *Wealth of Nations* well past the repeal of the Corn Laws. Indeed, it can easily be demonstrated that British average tariffs were in fact substantially higher than that of her neighbor France for some three-fourths of the nineteenth century.

Despite making claims to be a free trader, Britain did in fact retain many of her most important tariffs even after the Corn Law Repeal in the 1840s. The fact that most of the tariffs abandoned by the British were either of trivial importance or were tariffs on manufactures in which Britain had a comparative advantage has mostly gone unnoticed in the traditional historical literature (cf. Nye 2007).

It turns out that the tariffs were an integral part of the eighteenth century bargain that had been struck between the state and prominent merchant and industrial interests in Britain. In exchange for both protection from foreign competition and the preservation and encouragement of oligopolistic industry,
groups like the brewers and distillers of London were willing to support and to pay much higher excise taxes on their products than had been politically feasible in the period prior to the Glorious Revolution. This political bargain was behind the dramatic and sustained rise in government revenues in the eighteenth century. In addition, these excises, which were mostly borne by the denizens of the most urbanized areas, notably London, not only enriched the central government and its politicians, but it also bought the peace that allowed a shifting of the rules to gradually disfavor rural elites by sparing the landed aristocracy large increases in the land and related wealth taxes that would normally have been necessary to sustain the British war machine (Nye 2007).

What is important to remember is that these tariffs and restrictions, which were by no means harmless nor liberal, did not cripple the evolution of the British economy because they also served to promote the free movement of goods and services within the domestic economy.

It is sometimes forgotten that the ideas surrounding the promotion of free trade were as much, if not more, about domestic free trade as about open commerce between nations. If Britain was not a free trader in the international market, Britain was able to prosper because the British were among the most vigorous promoters of domestic free trade. At a time when the French were still struggling with a variety of local taxes and regulations that restricted trade between the regions of France until the end of the nineteenth century, the British state was using its power to see to the development of an ever more efficient and unrestricted domestic market. These changes, combined with encouragement of improved transportation, mattered more for the economy than the restrictions on foreign trade, simply because foreign trade did not play a large role in the first Industrial Revolution.

If these changes were so unusual and far-reaching, how were they accomplished? As should now be clear from the thrust of my narrative, it is because the major elites benefited from commercialization and could successfully cut off those who would oppose the spread of national commerce. And in turn, success in the economy provided rents to the dominant elites, who benefited from further extensions in the form of improved transport, better national institutions, and rapid industrialization. The fact that in the long run, the rise of an advanced market system disenfranchised and indeed destroyed the basis for the aristocracy itself did not interfere with the power or the will of those who stood able to gain from the transformation in the short run.
Adam Smith recognized this very bargain (or perhaps class betrayal is a better phrase) when he noted most pointedly: “For a pair of diamond buckles perhaps, or for something as frivolous and useless, they exchanged the maintenance, or what is the same thing, the price of the maintenance of a thousand men for a year, and with it the whole weight and authority which it could give them. The buckles, however, were to be all their own and no other human creature was to have any share of them” (Smith 1776, Book 3, ch. IV). The destruction of feudal privilege was fueled by the pride and avarice of the central government.

Yet it is too easy to view this cynically. It is certainly the case that ideas played an important and critical role as well, difficult as it may be to quantify their effects. Both Joel Mokyr (2009) and Deirdre McCloskey (2006) have been pointing to changes in the view of mankind and the state as critical determinants of European success in the Enlightenment. Certainly, elites in poor nations both before and after the Industrial Revolution have found ways to enrich themselves without doing half so much good for the economy and the polity as did the British in the eighteenth and nineteenth centuries. The fact that reformist or liberal ideas could only function through a mechanism that provided rents for those in power should not really surprise us. Where ideas are completely at odds with the interests of those in authority, it is unlikely that they are to make any viable headway. But when an opportunity for change presents itself that also enriches those in strategic positions, it helps when those in power have on their menu of possibilities ideas that promote efficiency, access, and freedom as central elements of successful reform. That those who successfully managed to shepherd what is now seen as a world-changing transformation did so for not entirely selfless reasons should neither shock nor dismay us.

It only remains to be seen if the current and future generations of scholars can build on the insights of North and others to derive useful theories to allow us to formulate effective, sustainable policies that encourage elite reform—reforms that function in the world as it is, and not as we wish it to be, either in our dreams or on the blackboard.

References


