

# ECONOMIC AND BUSINESS HISTORY 22/23

## LECTURE 5 - INSTITUTIONAL REVOLUTION



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### PLANO



1. The Argument



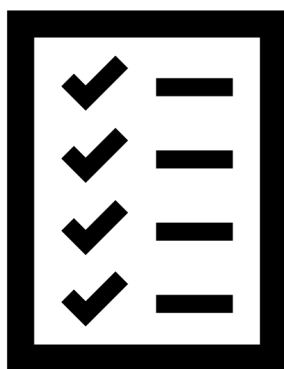
2. Better institutions in GB?



3. The trouble with the Continent

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# 1. The Argument



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## Back to the Pin Factory

The example of labour productivity increases in the pin factory presuppose two factors:

- that property is safe enough for the owner and the workers to improve productivity, i.e. that the respective rights will be protected from each other and from third parties (robbers or scammers)
- that the business and its returns will not be confiscated by a random pretext by any authority (local or central)



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## Investment and growth require a “Liberal State”



“According to the system of natural liberty, the sovereign has only three duties to attend to:

- 1) the duty of protecting the society from violence and invasion of other independent societies;
- 2) the duty of protecting, as far as possible, every member of the society from the injustice or oppression of every other member of it, or the duty of establishing an exact administration of justice;
- 3) the duty of erecting and maintaining certain public works and certain public institutions which it can never be for the interest of any individual, or small number of individuals, to erect and maintain; because the profit could never repay the expense to any individual or small number of individuals, though it may frequently do much more than repay it to a great society’.

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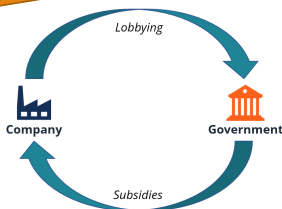


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## “liberal state” is not simply about justice and rule of law



“People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.”



A state also needs to refrain from being captured by the wealthy  
 Too often, states protect some trades or groups at the expense of others  
 state-sponsored companies mean the ‘state capture’ by ‘rent-seeking’ elites

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## Institutions are a obstacle to growth?

Sure!



The **natural effort** of every individual to better his own condition [faces] a **hundred impertinent obstructions with which the folly of human laws too often incumbers its operations**; though the effect of these obstructions is always more or less either to encroach upon its freedom, or to diminish its security.

In Great Britain industry is perfectly secure; and though it is far from being perfectly free, it is as free or freer than in any other part of Europe

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## 2. But were GB institutions really better?



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## “Glorious Revolution”

- The common argument is that a “Glorious Revolution” in 1688 created institutional conditions for economic growth that did not exist elsewhere
- In 1688, foundation of a new dynasty (Orange), supported by firmly protestant elites, who opposed Catholic King James II



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## “Glorious Revolution”

- A foreign king (and a succession of non-English rulers) decreased the role of the monarchy vis-a-vis the Parliament
- Parliament took over the regulatory powers of the monarchy, as well as it monopolized the right to tax (and to spend) in the early 1700s



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## “Glorious Revolution”

- The Glorious Revolution and the loss of constitutional powers of the king, was coupled by the creation of the B of England in 1694
- The foundation of the B of England implied that the quantity of money within the economy was not controlled by the executive power, which instilled confidence in both credit and capital markets



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## Institutional Superiority?

|                  | Great-Britain  | Eastern Eurasia  |
|------------------|--|--|
| Property rights  | Well-defined and protected by law  | Fragile and existence of seigniorial monopolies (Eastern Europe); unknown or informal and powerless before the state (China, Muslim states)              |
| Judicial System  | Reliable and predictable courts  | Difficulties in enforcing contracts; privileges of the lords and peasant communities; undefinition of laws   |
| Political Regime | Some checks and balances, and special interests have little representation | Serfdom; Feudalism (i.e., private entities, “lords”, exert public powers – judging, taxing, recruiting); absolutist state officials (mandarins in China) |

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## How revolutionary was the “Glorious Revolution”?

- This theory emphasises the differences between England and the rest of the continent
- However, parliaments (most of all, ones in which most seats were not disputed) are not necessarily less tyrannical than monarchs
- Also, Western (though not Eastern) Europe also had property rights, sovereign states and judicial systems



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## 3. The Continent



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# The “Continent”



States actively pursue the “Wealth Nations”

“Mercantilism” (Power = Wealth; Wealth = Precious Metals)

- Creates monopolies
- Imposes protectionism
- Builds import-replacing industries
- Diverts private capitals

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# Mercantilist States concentrate private capitals for their own ventures



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## The dangers of mercantilism



*It is thus that every system which endeavours, either by extraordinary encouragements to draw towards a particular species of industry a greater share of the capital of the society than what would naturally go to it, or, by extraordinary restraints, force from a particular species of industry some share of the capital which would otherwise be employed in it, is in reality subversive of the great purpose which it means to promote. It retards, instead of accelerating, the progress of the society towards real wealth and greatness; and diminishes, instead of increasing, the real value of the annual produce of its land and labour.*

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## What does Adam Smith have to say about this?



*All systems either of preference or of restraint, therefore, being thus completely taken away, **the obvious and simple system of natural liberty establishes itself of its own accord.** Every man, as long as he does not violate the laws **of justice**, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men. **The sovereign is completely discharged from a duty**, in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which **no human wisdom or knowledge could ever be sufficient**; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society.*

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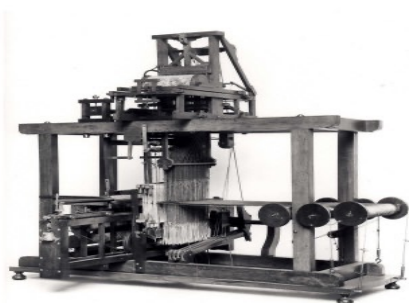
## The limits of state intervention

- Continental states were aware of the importance of improving labour productivity
- Higher labour productivity and better technology contributed to improve state power (at least via taxation)
- Thus, unlike in GB, where parliament was relatively neutral regarding agriculture, continental states sought to stimulate innovation
- An interesting case study is how Vaucanson (of the Vaucanson's duck fame) was appointed under Louis XV of France as the inspector of the manufacture of silk in France and charged with improving the tech
- He performed and invented an automatic silk loom that would replace most of the labourers
- Yet, this machinery was unsuccessful as French private silk businesses said that they would prefer to continue with low wages rather than to acquire and maintain the machine (even if they did not pay for the R&D)
- In England, however, a private inventor (Rev. Cartwright, a clergyman) successfully adapted the invention for cotton (a cheaper, but more adaptable material), further improving Labour productivity.

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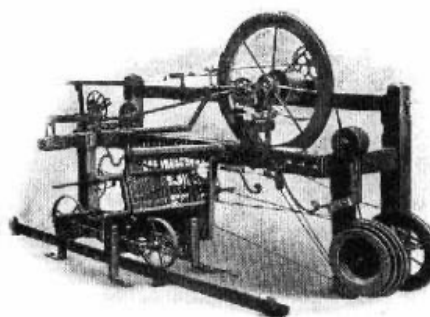
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## Invention



Automatic silk loom by  
Vaucanson, 1745.

## Innovation



Power loom Cartwright, 1789.

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