THE PARADOX OF THE WEST

by
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The search for the origins of modern freedom entails an inquiry both into the conditions that gave rise to the demand for freedom and into the origins of an ideology that promoted freedom as the basic ideal of a society--an ideology of such intellectual power that it is a driving force today in shaping the modern world. It is paradoxical that modern freedom is a product of a part of the world that was relatively backward a millenium ago. From our present day perspective there would appear to have been many more likely candidates--societies with more advanced economies, with more sophisticated scientific and technological knowledge, with more attention paid to the arts, literature, and the pursuit of knowledge in general. And, indeed, the development of the West did involve the relative advance of all those indicators of more advanced civilizations along with the progress of freedom. Therefore our search for the origins of freedom must do more than focus on the polity; it must provide an explanation for the overall rise of the western world.

A central thesis of this chapter is that economic growth and the development of freedom are complementary processes of societal development. Economic growth provides the resources (and leisure) to support more complex societies; and it is unlikely to persist in the long run without the development of political and civil liberties. A world of specialization and division of labor--the roots of economic growth--is going to nurture democratic polities and individual freedoms.

Why might there be such a relationship? The short answer is that well specified and enforced property rights, a necessary condition for economic growth, are only secure when political and civil rights are secure; otherwise arbitrary confiscation is always a threat. Also credible commitment--an essential condition for the creation of capital markets--is not possible without an effective legal system, one that will impartially and systematically enforce agreements across time and space. A longer but more satisfactory answer entails an analysis of the interplay between the more complex, interdependent economies that arise from division of labor; of the consequent evolution of diverse interests and their gradual increase in bargaining power; of the ideas and ideologies that would be congenial to such growing diversity; and of the influence of these belief structures on incremental institutional change. Such an approach can then account for the gradual widening over time of the spectrum of individuals and groups to whom freedom and liberties would be extended.

In what follows I hope to spell out not only the interrelationships that characterized this evolution but also the limitations of and qualifications to the overall thesis. That there is an historical relationship between economic growth and the development of freedoms is evident; the pioneers of modern economic growth, the Netherlands and England, were also the pioneers in the development of representative government and civil freedoms (and the countries that were left behind in western European expansion, Spain and Portugal for example, failed to develop those freedoms). That the relationship is not perfect is equally evident; I shall have occasion to briefly describe economies such as China that had periods of economic growth without producing either representative polities or individual freedoms and in the modern world we have only to turn to the former Soviet Union after World War II or the modern experience of some Asian countries. Economic growth may be a necessary but is not a sufficient condition for the development of modern freedom. So the puzzle we must unravel is what set of unique conditions--ones not present in more

advanced societies during the past millenium--set off economic growth and the development of freedoms in the west?. But there is an even more fundamental underlying puzzle: why has economic growth itself been so exceptional?

By economic growth I mean sustained growth in output per head of population. The key to economic growth is output growing faster than population. Throughout the long era of human history total output has grown and population has increased; but improvement in overall human well being associated with output growing faster than population has been much rarer. While the statistical data do not exist to give us unequivocal answers, per capita economic growth does appear to have occurred, for example, in the classical era in fifth century (B.C.) Athens before the internecine war with Sparta, in the era of Rhodian domination of the Eastern Mediterranean, and during the first two centuries of the Roman empire.1 Economic growth, then, is not uniquely associated with the Industrial Revolution despite a long scholarly tradition identifying the two. But sustained economic growth was the exception before the Industrial Revolution and, for that matter, after that revolution in eighteenth century England. Indeed, it is only in the very modern era since World War II that economic growth has been widespread. And it is only in the modern era that modern freedoms have become widespread.

The sources of economic growth have variously been ascribed by economists to technology, human capital (education and skills of human beings), and economies of scale (falling costs associated with the growth of large scale markets). While these are clearly proximate sources of productivity increase and hence growth, they are not the ultimate sources. If they were, growth would have long since become universal because the desire for improvement in well being appears to be a universal human trait and all societies would have to do is invest in the technologies or skills and knowledge that would produce such desirable results. But throughout history (and even in much of the modern world) societies have failed to make the "proper" investments.

Societies don't make the necessary investments because the institutional and organizational structure does not provide the incentives to do so. The failures of human organization underlie not only economic backwardness but social, intellectual, and political backwardness as well. Indeed the search for efficient economic organization leads us to political organization, since it is the polity that defines and enforces the economic rules of the game. It is in the complex (and still not completely understood) interplay between the economy and the polity that we must turn to search for the clues that account for the rise of the West. In going back a millenium to search for the roots of modern freedom, we must look both to the institutional framework and to the intellectual context from which sprang the perceptions that guided human actions. Most important of all, we must explore the dynamics of change that propelled the West into world hegemony.

I

Initial Conditions

Since history is about how yesterday's choices affect today's decisions, any starting point is not just arbitrary but does violence to the essential continuity of history. If we take an initial snapshot of northwest Europe of a millenium ago we do so, therefore, with a self conscious glance over our shoulder at the background sources of that landscape.

The Roman Empire disappeared in the chaotic conditions of the fifth century A.D; a more or less arbitrary historical chronology dates the end of feudalism about a millenium later, in 1500. In between these dates western Europe gradually emerged from the anarchy that followed the collapse of Roman order and the overrunning of western Europe by Germanic tribes, to develop the political and economic structure which set the scene for subsequent developments. This evolution was basically conditioned by the heritage of Greco-Roman civilization which persisted (particularly in southern Europe), modifying and ultimately shaping many of the institutional arrangements that emerged in the sixth to the tenth centuries. The manor appears to be a lineal descendent of the Roman villa and the dependent coloni a predecessor of the serf of the feudal world. Slavery, too, continued

into the Middle Ages. Roman law continued and where order evolved served as the basis for the development of property rights.

The Church carried over the cultural heritage of the classical world to the Middle Ages. It was the lonely repository of learning (and indeed monasteries were frequently the most efficient farming centers of medieval Europe). If the Church was a major possessor of material wealth, selling salvation in return for treasure and land, it was also characterized by asceticism, hermit life, and devout missionaries. Most important, it provided a unified belief structure, an ideological frame of reference, that shaped perceptions in the medieval world. This common frame of reference served as the basis for the ongoing evolution of perceptions that would guide choices shaping the future of polities and economies.

Northwest Europe was a geographic contrast to the Mediteranean rim, the seat of Greco-Roman civilization. The latter was characterized by light and/or seasonal rainfall, light soils, and a varied agriculture ranging from viticulture and olive trees to cereals; the former by abundant rainfall, thick forests, and heavy soils that suited it to livestock and, with appropriate modifications of ploughs, cereal production. These climatic and geographic features determined the agrarian structure of the economies of northwest Europe.

These institutional, intellectual, and geographic background conditions of tenth century life in northwest Europe must be set in the context of the most fundamental initial organizational condition--the lack of large scale economic and political order. The disintegration of the Roman Empire presaged more than half a millenium of small scale political units. Whatever advantages had existed in large scale political-economic organization were absent or severely diluted in the era that followed. The Roman Empire did persist in the East until Constantinople was taken by the Turks in 1453; the Moslem world built on the charismatic faith of the new religeon did create an empire spreading over North Africa and into Europe. But neither these exceptions nor the short lived Carolingian Empire gainsay the critical point that the conditions that made possible a single empire governing the Mediterranean world had disappeared.

Assault from three directions, by Vikings, Magyars, and Moslems, imposed its stamp on the region. Vikings appeared off the coast of England in 786, of Ireland in 795, and of Gaul in 799. London was sacked in 841; Viking longboats moved up navigable rivers to attack such diverse towns as Rouen in the north and Toulouse in the south. Hungarian horsemen raided Bremen in 915 and reached as far west as Orleans in 937. Moslem corsairs roamed the Mediterranean and raided the coast from southern Italy to Provence.

The viable response was the fixed fortification, the heavily armored knight, and the hierarchical, decentralized structure of feudalism. The military result was something of a stalemate. The castle was impregnable to all but the most persistent--and well financed--opposition that could undertake the siege necessary to starve out the inhabitants; warfare was typically small scale between heavily armored knights. The Vikings were repulsed at the siege of Paris in 885, the Magyars were defeated near Augsburg in 995, and Moslems raiders were defeated on the River Garigliano in 915. In consequence there was a revival of local order, an expansion of manors--ones being carved out of the wilderness--and a growth of towns. And it is in the context of these initial conditions that the complex interplay between political, economic, and military changes initiated the unique conditions that led to sustained economic growth.

Economic activity took place within the manor (with some exceptions) and in towns. Manorial organization was typified by a threefold division of land into the lord's demesne, the peasant holdings, and the commons. The majority of peasants were bound to the manor as serfs owing labor services (two or three days a week) and dues to the lord of the manor. They were subject to the lord's jurisdiction, had to seek justice in the lord's court, and were restricted in their movements and in their economic transactions.2

Traditional manorial organization provided scant encouragement for economic growth. The isolation of the manor inhibited specialization and division of labor and slowed the diffusion of technology when it did develop. The incentives imbedded in the customs of the manor provided little impetus for the rapid growth of skills and knowledge or technological change. The heavy plough with wheels, moldboard, and colter; the horsecollar; and the horseshoe did make their appearance although the shift from oxen to horses came mostly after the ninth century and then only slowly.3 Likewise the shift from the two-field to the three-field system of crop rotation was a very gradual change. But population was growing at least from the tenth century on, most likely as a result of the relative improvements in order that followed the end of the incursions of Vikings, Magyars, and Moslems. And this population growth (and subsequent decline) would play a major role in altering the manorial organization.

The evolving towns were the centers of rapid economic--and political--change in response to the improved establishment of order over larger areas. Whether the numerous city republics of north and central Italy or the urban centers that grew up in the Low Countries in the tenth century, they were sources of dynamic changes resulting from the opportunities of expanding trade in the Mediterranean or the basins of the Scheldt and the Meuse and ties both to south Europe and the Baltic and North Sea coastal areas.

Prior to 1300 trade was carried on primarily by traveling merchants. Such traders often formed societies for mutual protection; some of these even required their members to be suitably armed when traveling in caravans, indicating that problems of peace and order had not been completely settled. The importance of traveling merchants--and of fairs--began to decline after 1300.4 The growth of trade fueled the growth of towns and the settlement of merchants further accelerated their development. The constraints imposed by geography and the high costs of land transport dictated the urban locations: at the head of a gulf (Bruges), where a road crossed a river (Maestricht), near the confluence of two rivers (Ghent), or at a breakpoint in transportation (Brussels).

II

The Sources of Institutional Change

The tenth to the sixteenth centuries in northwest Europe appear to have been a kaleidescope of endless warfare at every level, from the local ubiquitous internecine conflicts of barons to the relatively large scale battles of the Hundred Years War in which the English routed the French at Crecy, Poitiers, and Agincourt and the French turned the tables at Formigny and Castillion. They were also an era of radical demographic change, with population growth from the tenth to the fourteenth centuries and then a decline beginning in the early fourteenth century that probably persisted for 150 years before being reversed.

The changes in military technology, from the effectiveness of the longbow in the English victories to the advent of effective artillery with the French victories (not to mention the effectiveness of the pike phalanx in undoing heavily armored French knights at Courtrai in 1302), led to profound changes not only in the nature of warfare but in the viable size of political units.5 Warfare became more costly both because of the costs of training disciplined units and because of the increased capital costs of the offensive and defensive equipment. Whether the result was the dangerous employment of skilled mercenaries or the initiation of a professional standing army by Charles VII of France, political units needed more revenue to survive than could be obtained from a sovereign "living of his own" from traditional feudal sources. Yet if the fiscal needs of the sovereign had increased, the potential resources to generate additional revenue in the economies had also increased. The establishment of order over larger areas, noted in the previous section, resulted in profound changes in population, the growth of trade, the expansion of markets, and the widespread development of money economies.

The demographic decline of the fourteenth century produced a precipitous decline in urban populations, particularly as a consequence of the bubonic and pneumonic plagues.

The immediate consequence was an absolute decline in the volume of trade and commerce and in the revenue available to be taxed or appropriated by princes. But the decline in commerce was not equal to that in population. The basic institutional structure of rules and laws persisted and provided the essential framework that would serve as the basis of growth when population revived. Population decline had a more fundamental impact on agrarian organization. It led to a change in the land/man ratio that made labor scarce and forced an increased competition amongst landlords, which ultimately altered the organization of the manor and of agriculture.

The revenue necessary to fiscally strapped rulers could be confiscated, could be borrowed (particularly from Florentine bankers), or could be traded by constituent economic groups in return for services provided by the sovereign. All these methods were tried. Confiscation killed the goose that laid the golden egg. Eventually Florentine (and other) bankers were burned by repudiation--but not before monarchs had been supported in expensive wars and some bankers had realized handsome profits from Crown monopolies and other favors from rulers. The third method the exchange of services--particularly the granting and enforcing of property rights--for revenue produced a wide variety of structural changes, from the protection of alien merchants, to the incorporation of guild and merchant law into legal codes and enforcement by the state, to the establishment of Parliament, Estates General, and Cortes.

III
Institutional Changes

The implications of these military and demographic/economic changes for institutional and organizational change were profound. The economic changes in agriculture were away from the self sufficient manor with dependent labor (serf, slave, or free) towards a market- oriented agriculture (particularly pronounced adjacent to town and cities) of landlords and peasants bound together less by customary rights and obligations and more by an evolving structure of property rights.

The growth of towns and cities around an expanding national and international commerce was made possible by a number of institutional and organizational innovations. The evolution of the bill of exchange and the development of techniques for negotiability and discounting required the development of centers where such events could occur--the Champagne and other fairs, banks, and eventually financial houses that would specialize in discounting. Marine insurance evolved from sporadic individual contracts covering partial payment for losses to standard printed contracts offered by specialized firms. Marine insurance was one way to spread risks; another was business organization that permitted either portfolio diversification or the aggregation of a number of investors such as the commenda, the regulated company, and finally the joint stock company.6

The mechanisms for contract enforcement appear to have had their beginnings in internal codes of conduct of fraternal orders of guild merchants, which were enforced by the threat of ostracism. These codes evolved into merchant law and spread throughout the European trading area; gradually they became integrated with common and Roman law and enforcement was eventually taken over by the state.7

The last point is critical. The economic institutional structure was made possible by the evolution of polities that eventually provided a framework of law and its enforcement. Such a framework is an essential requirement for the impersonal exchange that is necessary for economic growth. The development was a long process of (some) polities gradually shifting from Mafia-like extortion to trading "protection and justice" for revenue. The initial impetus for this development was the desperate search for additional revenue; but as noted above that search could take several forms--confiscation or debt repudiation on the one hand or the trading of property rights and their enforcement for revenue on the other.

Radically different results ensued from the divergent policies of rulers in the face of fiscal crises but the one constant was the gradual emergence of the nation state whether

in the context of the economic growth that characterized the Netherlands or of the stagnation that ensued from Spanish policies.

To understand the success of the Netherlands one must cast a backward glance at the evolution of prosperous towns of the Low Countries such as Bruges, Ghent, and Liege; their internal conflicts; and their relationship to Burgundian and Habsburg rule. The prosperity of the towns, whether based on the wool cloth trade or metals trade, early on made for an urban centered, market oriented area unique at a time of overwhelmingly rural societies. Their internal conflicts reflected ongoing tensions between patrician and crafts and persistent conflict over ongoing efforts to create local monopolies which, when successful, led to a drying up of the very sources of productivity which had been the mainspring of their growth. The overall impact of the advent of Burgundian control was to discourage restrictive practices. In 1463 Philip the Good created a representative body, the States General, which enacted laws and had the authority to vote taxes for the ruler (although each province kept its own Estate and the delegates to the States General were given limited powers). This assembly encouraged the growth of trade and commerce. The Burgundian (and later Habsburg) rulers themselves, in spite of vigourous opposition, actively discouraged monopoly privileges embodied in guild and trade restrictions such as those in the cloth towns of Bruges and Ghent. The rulers were supported by new centers of industry that sprang up in response to the favorable incentives embodied in the rules and property rights. The Burgundians and Habsburgs were rewarded by a level of prosperity that generated tax revenues that made the Low Countries the jewel in the Habsburg Empire. Eventually the ever more exacting revenue demands of Philip II led to revolt, the sacking of Antwerp, the successful separation of the seven northern provinces, and the rise to commercial supremacy of Amsterdam. And it was in the Netherlands and Amstersdam specifically that modern economic growth had its genesis.

Contrast this brief story of economic growth with that of Spain. Ferdinand and Isabella united Castile and Aragon to form a nation state after centuries of strife with the Moors and ceaseless internal wars among feudal barons. When Charles V ascended the throne in 1516 the great era of Spanish hegemony over Europe was initiated. It was characterized by prosperity with growing fiscal revenues from Aragon, Naples, Milan, and particularly the Low Countries. Increased revenues were matched by increased expenditures as Charles V maintained the largest and best equipped army in Europe. Maintaining and expanding the Empire, however, was ever more costly; and when the Low Countries revolted against Charles V's successor, Philip II, the result was not only to lose a major source of revenue but to incur the additional expenses of war with the seven provinces. The fiscal crisis deepened as treasure from the New World declined. The desperate search for revenue led to granting local monopolies for revenue, to confiscations, and to ever higher rates of domestic taxation. The predictable results were a decline of trade and commerce and bankruptcies of the state in 1557, 1575, 1596, 1607, 1627, and 1647.

These contrasting stories of economic growth and decline have been, with appropriate but usually minor modification, repeated endlessly in history and in the modern world. Growth has been generated when the economy has provided institutional incentives to undertake productivity-raising activities such as the Dutch undertook. Decline has resulted from disincentives to engage in productive activity as a consequence of centralized political control of the economy and monopoly privileges. But the failures vastly exceed the successes. Economic growth has been the exception. Stagnation and decline have been the rule, reflecting a persistent tendency toward failure in human organization. Both the successes and failures reflect more than institutional/organizational characteristics of societies. They equally reflect perceptions, ideas, ideologies--the beliefs that guide human choices and actions.

IV
Cultural Beliefs and Societal Organization

Just what is the relationship between beliefs and the human condition? In his justly celebrated study, The Protestant Ethic and the Spirit of Capitalism,8 Max Weber puts the emphasis on beliefs. In contrast the dedicated neo-classical economist is wont to believe that ideas, ideologies--indeed beliefs in general--don't matter because people go about pursuing what is in their self interest. But the economist assumes not only that self interest always guides choices but that individuals know what is in their self interest; that they have correct theories and hence make choices that will lead to the desired outcomes. In fact, however, humans face a world of uncertainty and the mental models that they construct to interpret the world around them and that determine their choices are models derived from their subjective--and typically very limited--experiences. In consequence diverse dogmas, myths, ideologies, and ideas have shaped and continue to shape human action. But if ideas matter, just how do they matter?

Let us look at Weber's study. He is concerned to show that the religious ethic embodied in protestantism---and specifically Calvinism--contained values that promoted the growth of capitalism. But which way does the causation run; and how do we know that both the values and the growth of capitalism did not stem from some other source?9 Weber makes a connection between religious views and values, and between values and economic behavior; but he does not demonstrate how the consequent behavior would generate the growth of the specific institutions and organizations that produced a growing economic system.10 Moreover Counter-Reformation Catholicism may have equally encouraged the same individualism and sense of discipline that Weber uniquely ascribes to protestantism.

It will be useful to consider the relationship between behavioral beliefs and the evolution of specific institutional and organizational structures because this approach provides an explanation for such evolution. A long standing view of many scholars has been that individualistic behavioral beliefs are congenial to economic growth. Alan Macfarlane's controversial The Origins of English Individualism11 traces the sources of English individualism back to the thirteenth century or earlier. It paints a picture of a fluid, individualistically oriented set of attitudes towards the family, the organization of work, and the social structure of the village community. These attitudes were manifested in a set of formal rules dealing with property inheritance and the legal status of women.

More recently Avner Greif12 compares Genoese traders with traders who had adopted the cultural and social attributes of Islamic society in the Mediterranean trade of the eleventh and twelfth centuries. He detects systematic differences in their organizational structures traceable to contrasting individualistic versus collectivist behavioral beliefs. The traders from the Islamic world developed in-group social communications networks to enforce collective action which, while effective in relatively small homogeneous ethnic groups, do not lend themselves to the impersonal exchange that arises from the growing size of markets and diverse ethnic traders. In contrast the Genoese developed bilateral enforcement mechanisms which entailed the creation of formal legal and political organizations for monitoring and enforcing agreements--an institutional/organizational path that permitted and led to more complex trade and exchange. Greif suggests the generality of these different belief structures for the Latin and Muslim worlds and then makes the connection between such belief structures in the European scene and the development of the economic institutions and organizations described briefly in the preceding section III.

But if we accept that there were different behavioral beliefs in different societies and that they induced different forms of institutions and organizations, what produced the beliefs? The major candidate is religions since they were the dominant organized belief structures of the pre-modern world. The vast literature dealing with the effect of religious dogma on economic activity is, however, inconclusive since it is possible to pick out specific aspects of almost any religion that are antithetical to economic growth. Some of

these are the Islamic opposition to insurance markets13 and the Christian opposition to interest payments.

The proper focus, however, should not be on specific norms but on the learning process by which a particular belief structure--in this case religion--evolves. The learning process is a function of 1) the way in which a given belief structure filters the information derived from experiences and 2) the different experiences that confront individuals in different societies at different times. Thus one can argue that the Christian religious framework of the Middle Ages provided an hospitable filter for learning that led to adaptations congenial to economic growth; or alternatively that the specific geographic/economic/institutional context of the medieval western world described in section III provided the unique experiences responsible for the resultant adaptations. In fact it was a combination of the two that produced the adaptations in the belief structure that were conducive to economic growth and political/civil freedoms. The belief structure embodied in Christian dogma was, despite some notorious contrary illustrations, amenable to evolving in directions that made it hospitable to economic growth. Both Ernst Benz14 and Lynn White15 maintain that Christian belief gradually evolved the view that nature should serve mankind and that therefore the universe could and should be controlled for economic purposes. Such an attitude is an essential precondition for technological progress. But it was particularly the unique institutional conditions of parts of medieval/early modern Europe that provided the sort of experiences that served as the catalyst to precipitate such perceptions. From this perspective Weber's protestant ethic is a part of the story of this adaptation but is "downstream" from the originating sources.

V
What Happened Elsewhere

The foregoing analysis suggests that the western European experience was unique both in its institutional configurations and its belief structure. But it does not answer the fundamental question of just what conditions are necessary and sufficient to induce economic growth and the evolution of freedoms. If economic growth is a necessary condition, what additional attributes will assure the evolution of freedoms? The unequivocal answer is that we don't know--as is evident from the fumbling efforts being made in the modern world to revive failed economies and produce democratic polities. Therefore we have a less than satisfactory explanation for why the more advanced economies and societies of the rest of the world of earlier times did not provide the setting for the onset of economic growth and the development of modern freedom.

A major failing of the literature of both economic history and economic development is that the emphasis is upon technology as the impetus for economic development--and hence we have endless studies of technological failure or stagnation. In fact, the key to growth is the institutional/organizational structure and its effect upon incentives--not only the incentives to invent and innovate, important as they are, but the incentive to organize the production process more efficiently, to reduce transaction costs in factor and product markets, to organize a judicial system to enforce contracts, to create a polity that will specify and enforce property rights, and most important of all to maintain those incentives. In this context we may not know how to realize such desirable objectives but we do have some understanding of what doesn't work. The following very brief analysis of earlier advanced societies that failed to develop concentrates on those negative features.

China is the leading candidate to have produced sustained growth and freedoms. The technological bias of historical scholarship has made a major puzzle out of the failure of that society to continue the development that made it a world leader in technology. Joseph Needham's massive scholarship16 has provided us with detailed knowledge of China's early scientific and technological achievements. Over much of the more than two millenia since that country was unified it appeared to be more advanced than any other civilization and certainly during the Sung dynasty (tenth to the thirteenth centuries) gave

indications of real economic growth. R. M. Hartwell asserts that the level of Chinese iron output in 1078 was equal to that of all of Europe in 1700.17 As late as the Ming dynasty (beginning in the fourteenth century) China was preeminent in technology.

The search for an explanation of both periods of apparent real growth and technological creativity and other periods of slow growth or stagnation must explore either changes in the external environment that altered opportunities or changes in the internal incentive structure that altered opportunities. Eric Jones in an original and imaginative study18 argues that the non western world was more prone to disasters (floods, earthquakes, plagues) than was the west and in a later study19 that the Jurchen and then Mongol invasions were a negative influence on growth. He leaves open, however, whether such forces rather than the structural aspects of Chinese society were the critical deterrents. Certainly changes in the external environment can account for a part of the uneven pattern of change; but a more abiding long run source of uneven evolution was the persistant character of the Chinese polity. It was not always or even usually a strong state, but it was a centralized state in which the decisions over property rights emanated from the center and could be and were changed by the whims of an emperor. Centralized decision making can make for periods of growth when a ruler perceives his or her interests are furthered by a set of rules that generate growth; but equally it can, and inevitably will, produce the reverse when a ruler, either because of fiscal crises or because of ideological beliefs, perceives his/her interests to be furthered by policies and hence incentive structures that induce stagnation. Chinese history is replete with arbitrary alterations in policies that fundamentally influence opportunities. Karl Wittfogel's Oriental Despotism20 had the wrong explanation for the centralization (a consequence of an irrigation system) but the right intuition that centralized controls are antithetical to development in the long run. Left unanswered here is why the periods of growth did not lead to a breakdown of centralized controls and the evolution of freedoms.

Islam, like China, possessed technological, architectural, literary, and scientific credentials that made it appear a likely candidate for economic growth. The period from 700 to 1100 has been described as "an Arab agricultural revolution"21 with the widespread diffusion of new crops and the promotion of new or the rehabilitation of old irrigation systems. Islamic law provided clearly specified individual rights to water and a tax system that encouraged agricultural investment. In commerce, merchants of the Islamic Empire pioneered in the fields of business organization and finance. Capital was usually pooled either through partnerships or the use of the commenda (an arrangement used in long distance trade in which a sedentary merchant would dispatch a "junior partner," usually a relative, to sell the cargo and obtain a return cargo). Letters of credit and promissory notes were widely used in long distance trade.22 In technology, the Arabs developed the lateen sail, were pioneers in paper production, and were preeminent in a number of areas of chemistry and metallurgy.

At its peak the Empire exceeded the Roman Empire, and as late as the seventeenth century it was a military threat to Europe. And even the assertion that the Islamic faith was not conducive to economic growth, an assertion that superficially appears attractive in the light of modern Islamic economies, has been challenged: Maxine Rodinson assets that there is nothing in Islamic precepts that was contrary to fostering growth either in the past or in the present.23 But just what did prevent economic growth in the past, and for that matter in the present (aside from countries blessed with the windfall results of possessing oil)? It is certainly correct that individuals of Islamic faith have frequently exhibited all the individual acquisitive characteristics associated with achievement motivation and in other settings have been effective entrepreneurs. And that is precisely the point. It is the interplay between the belief structure and the external environment that shapes the evolution of a belief structure. Throughout most of history (with rare exceptions such as the Abbasid Caliphate of Baghadad in the ninth century) the external environment was not one that was conducive to intellectual evolution so that (to quote William McNeill) "by a curious and fateful coincidence, Moslem thought froze into a fixed mold just at the time

when intellectual curiosity was awakening in western Europe--the twelfth and thirteenth centuries A.D."24 Just as it was the environment of western Europe that was influencing the evolution of the belief structure towards flexibility, the Moslem environment and specifically polity were enforcing conformity and stiffling creativity. As in the case of China there were specific historical periods when a Moslem ruler fostered trade and commerce but others when the state exercised arbitrary control over property rights and practiced confiscation. The Ottoman Empire, for example, enjoyed heady success in the fifteenth century but evolved into a warrior, plundering state.

The Mughal Empire of India might be still another candidate for economic growth. The caste system certainly would militate against an efficient labor market but again it is in the characteristics of the state that the real obstacles to economic growth obtained. The Mughal conquerors ran the society to maximize the (short term) rents they could extract from the peasant village economies that India comprised. High taxes and confiscation militated against capital formation. In sum, the Mughal Empire was not a serious candidate.

VI
Economic Growth and the Evolution of Freedom

The burden of the previous section was that none of the likely candidates to have originated modern freedom possessed the unique attributes of a belief structure and an institutional framework that were conducive to long run economic growth and the evolution of freedoms. Just what setting might provide such a belief structure and institutional framework? Or to state the issue a little differently, why wouldn't any wealth maximizing ruler encourage economic growth and grant more freedoms to his/her subjects? A ruler stands to get richer via more tax revenue by encouraging economic growth. This objective can be accomplished by incentives to promote productivity and by allowing constitutents to retain a part of the increased income that results. However the ruler faces a tradeoff between the increased income he can obtain and the increased threat to his security that the relaxed restrictions result in because the constituents have both more freedom of action and resources to overthrow him. The constituents too face the dilemma that the ruler may at some point renege on his promises and confiscate their accumulated wealth. The solution to the dilemma facing the parties is for the ruler and constituents to make bargains such that it is in both of their interests to live up to the bargains or for the ruler to bind himself/herself irreversibly to a course of action that will promote economic growth--for instance giving over rights and coercive power to constituents or their representatives. The latter policy will lead not only to the evolution of representative government but also to the rule of law.

Time is a crucial element in such a scenario. That is, such credible commitment can only be realized over a long period of time; the ruler can realize such gains only with long term agreements and constituents have no way of trusting an absolute ruler except by observing his/her conduct over time.

If we take a long enough time perspective something like this evolution appears to have occurred, and indeed it bears a superficial resemblance to English history. But when we examine the historical record carefully, much of it is at variance with this account. What is the matter with such a scenario? Why don't we observe such evolution in history? Is it because rulers weren't motivated by self interest, rulers didn't know their own self interest, they or the constituents didn't have the time to reach such agreements? Probably all of the above were factors, although given the historical record rulers do frequently appear to have been self interested to the extent that they attempted to extract a maximum amount of (short term) wealth from constituents. But underlying motivation and the realizing of objectives is the belief structure that individuals possess. And the external environment determines the time horizons that ruler and constituents use in making decisions.

Not only are individuals not solely motivated by self interest; achieving their objectives, whatever the motivation, entails their having theories about how to do so. How does a ruler know what will be the outcome of granting constituents more freedom? Even today we have wildly conflicting views about how to achieve economic, political, or social objectives. The belief structure that guided such decisions--and still does--is a hodge-podge of theories, dogmas, and ideological preconceptions sometimes leavened by informed evaluation.

And as for the external environment, the time horizon of rulers was--and still is--the short run, not just because in Keynes's memorable phrase "in the long run we are all dead" but because the very nature of the political process militates against long time horizons. Fiscal crises as a consequence of wars or internal conflict have historically been a major reason for the short time horizon of rulers; so has their mortality (although sometimes their time horizon has been leavened by the utility derived from heriditary succession).

But in addition to the cognitive belief structure and the external environment there is still one other factor that we must take into account in an understanding of the way societies evolve--and that is path dependence. Once on a particular path it is very difficult for societies to radically alter directions. An economy with a tradition of economic stagnation or growth is not easily altered in the other direction. The explanation goes to the heart of the way institutions affect societal performance. Institutions are the structure that humans devise to reduce uncertainty in their dealings with each other and are composed of formal rules such as laws and informal constraints such as norms of behavior and conventions. Institutions are the key to the incentive structures which guide the way societies evolve and therefore determine the kinds of organizations that will arise to take advantage of the opportunities that the institutional framework has created. Thus if we have laws and rules that reward productive economic activity we can expect that organizations such as partnerships and firms will emerge to take advantage of those opportunities. And most important of all, the individuals in those organizations will have a stake in perpetuating such laws and rules. Thus the organizations that arise as a result of a particular institutional configuration result in turn in a powerful interest group whose survival depends on maintaining that set of institutions.

But there is a perhaps an even stronger force making for path dependence: the informal constraints of norms of behavior are derivative from the cognitive belief structure and therefore reinforce support for a given institutional framework. For that reason change tends to be incremental and revolutions when they do occur are never as revolutionary as the term implies. While the formal rules can be changed overnight, the informal constraints are much more impervious to change and impose a powerful drag on abrupt change. Thus a tradition of economic growth and freedom has built in powerful support for its maintenance, just as a tradition of economic stagnation and totalitarian rule with centralized bureacratic controls has equally created powerful organizational support (from the favored bureaucracy) for its perpetuation. Therefore even if a ruler did want to alter the path of an economy away from stagnation to economic growth he/she would face formidable opposition from the entrenched existing interests--as many rulers both in the past and in the present have discovered.

VII
The Paradox of the West

We are now ready to unravel the paradox of the west. There are still gaps in our understanding and puzzles to be resolved. Moreover a more complete story would devote more attention to the costs associated with both economic growth and the development of freedoms. There were losers--lots of them along the way--whose conditions deteriorated in the course of the changes described. But overall the material conditions of human beings and the security of persons and property over a range of civil, political, religious, and economic activities improved.

Putting at the center of inquiry the institutional/organizational structure of the society, we can explore the interplay between economic and political organization in the context of changes wrought by changing perceptions of the participants or by forces external to them. The failures of the most likely candidates, China and Islam, point the direction of our inquiry. Centralized political control limits the options, the alternatives that will be pursued in a context of uncertainty about the long run consequences of political and economic decisions. It was precisely the lack of large scale political and economic order that created the essential environment hospitable to economic growth and ultimately human freedoms. In that competitive decentralized environment lots of alternatives were pursued; some worked, as in the Netherlands and England; some failed, as in the cases of Spain and Portugal; and some, such as France, fell in between these two extremes. But the key to the story is the variety of the options pursued and the increased likelihood (as compared to a single unified policy) that some would turn out to produce economic growth. Even the relative failures in Western Europe played an essential role in European development and were more successful than the Empires because of competitive pressures.

The last point deserves special emphasis. It was the dynamic consequences of the competition amongst fragmented political bodies that resulted in an especially creative environment. Europe was politically fragmented; but it was integrated in having both a common belief structure derived from Christendom, and information and transportation connections that resulted in scientific, technological, and artistic developments in one part spreading rapidly throughout Europe. To treat the Netherlands and England as success stories in isolation from the stimulus received from the rest of Europe (and to a lesser degree Islam and China) is to miss a vital part of the explanation. Italian city states, Portugal, and Germanic states all fell behind the Netherlands and England; but banking, artistic development, improvements in navigation, and printing were just a few of the obvious contributions that the former states made to European advancement.

With the advantage of hindsight can we be more specific? The lack of large scale order in Eeurope in the early medieval period meant that the source of decision making was in the town or in the manorial/feudal heirarchy. This decision making was conditioned by the cultural heritage that shaped the initial perceptions of the participants. Let us begin with the role of the town on the continent of Europe.

The towns in medieval western Europe varied--from the Italian city state, to fortress towns built in response to the threat of external aggression, to local administrative towns; but in all cases a key factor in their evolution was the degree of autonomy from external authority they enjoyed. It was the relative freedom of European towns from such authority that was an initial distinguishing factor as compared to towns elsewhere. As economic opportunities emerged with the relative increase in order and therefore a decline in the transaction costs of trade, the towns were in a position to take advantage of the new opportunities-- whether it was the Mediterranean trade of the Venetians and Genoese or the woolen and metal trade of the Low Country towns with northwest Europe. The expansion of commerce led to the growth of a new interest group, commercial interests, alongside the traditional nobility, Crown, and clergy. Towns were able to gain liberties often over the opposition of nobles and clergy. This liberty to come and go, to buy and sell as they saw fit was as essential to economic growth as some security of property. The Protestant Reformation evolving in the context of repression, introduced a concern for another liberty--liberty of conscience, the freedom to worship as one chose; and economic liberty, religious freedom, and representative government became intertwined issues.

The commercial expansion of the eleventh to the fourteenth centuries produced not only an increase in urban places but also the development of commercial networks linking together the trade of northwest Europe with that of the Mediterranean. The organizational framework of fairs, guilds, law merchant, and the organizations that facilitated the use of the bill of exchange--briefly described above-- required an institutional framework of political and economic order. Order necessitated both the creation of a framework of rules

of the game inside the town and equally the establishment of rules and their enforcement that permitted exchange across political boundaries.

The political/economic order within Low Country towns has been eloqently described by Henri Pirenne in his Early Democracies in the Low Countries.25 Pirenne's story is one of the creation of the institutional infrastructure of democratic order within thriving town economies, which was gradually undermined by guild restrictions and conflict between patrician and lesser citizenry over control of the polity. But for Pirenne "the municipal democracies of the Middle Ages consisted, and could only have consisted, of privileged members. They did not, and could not, know the ideal of a liberty and an equality open to all."26 For Pirenne this democracy was pragmatic and unleavened by intellectual pretensions of democracy and egalitariarianism and therefore not like modern democracy.

That may be correct; but what Pirenne was describing was an integral part of a process of fundamental change. Political reordering and inevitable internal conflicts are everywhere in history a part of the process of economic expansion--a conflict not only internal to the town and its evolving interest groups but also external in its relationship with princes and rulers. To reiterate an ongoing theme of this chapter, change was overwhelmingly an incremental process, building onto and modifying the pre-existing institutional framework and constrained by the belief structure that prevailed. It is precisely that process of institutional/organizational incremental evolution that Pirenne describes in his story of the way the various political and economic organizations evolved and interacted with each other. It is not an inevitable triumph of democracy that is taking place, but a struggle for control of the polity. And as for a belief structure that embodied modern sentiments of democracy and egalitarianism: that was surely not a part of the perceptions of that time, either in the town or in the countryside.

England evolved along a route to economic growth and freedom different from that of the Continent. Being an island made it less vulnerable to conquest and eliminated the need for a standing army. The belief structure, as Macfarlane makes clear, was different. The Norman conquest, the exception to British invulnerability to external conquest, produced a more centralized feudal structure than any on the Continent; but as the Magna Carta attests, the Crown could not overstep the traditional liberties of the barons who had dictated the charter's terms or of towns, foreign merchants, and villeins. England's political institutions also differed in several important ways from those of its neighbors on the Continent. The most important was the unity of its parliament. There was a single parliament for the entire country; no regional estates as in France, Spain, and the Netherlands. There was also no division into towns, clergy, and nobility. Maitland pointed out: "It is a noticeable fact that at a very early time, perhaps from the beginning, the citizens and burgesses sit together with the knights."27

Both on the Continent and in England the changing status of serf, and free labor, on the manor was certainly not guided by any change in the perception of their inferior status. Rather, the gradual evolution of longer leases, reduced obligations and shift to copyhold (in the west) reflected a change in the relative scarcity of labor as a consequence of population decline in the fourteenth century, the alternative oppportunities that the towns provided, and the competition for labor that resulted.

In combination with the development of markets, towns, and trade as a consequence of the relative improvement of order and the demographic changes, we must consider the fiscal crises of princes. Such crises arose as a consequence of the ubiquitous warfare among competing political units and the growing costs of warfare. They played a key role in the political/economic changes that occurred. Between 1200 and 1500 the many political units in western Europe went through endless conflicts, alliances, and warfare and gradually evolved into nation states although it was not so much the size of the political unit that was critical for survival as it was the ability to increase tax revenues. It had been customary for the ruler to receive revenue in kind and indeed in some cases to move the court from one part of the country to another to consume the goods and services

in kind. With the growth of a money economy as a consequence of the economic expansion of the eleventh to fourteenth centuries, revenues became monetized; then in the fourteenth and fifteenth centuries they declined as a result of the fall in land rents because of declining population.

A year of warfare resulted in as much as a four fold increase in the costs of government--and warfare was endemic. Declining revenues and increasing fiscal costs posed an ever worsening dilemma for European princes. Custom and tradition set limits on the exactions they could obtain from lesser lords and, as the Magna Carta attests, a king who stepped across the boundary of accepted custom faced the possibility of revolt. The king's vassals were sometimes as powerful as he and in concert were more powerful. Moreover vassals could and did sometimes combine with foreign princes to overthrow the king; therefore increased taxation of vassals could place a Crown in jeopardy.

While the degrees of freedom of princes varied, one option available to them was to grant privileges--property rights--in return for revenue. As trade and commerce grew beyond the bounds of the town or manor, merchants found that the private costs of protection could be reduced by a larger coercive authority and were willing to pay princes to provide protection.

In order to prevent loss of revenue (from evasions) rulers granted rights to alienate land or to allow inheritance, thereby establishing more secure and efficient property rights. Towns were granted trading privileges in return for annual payments; alien merchants were granted legal rights and exemptions from guild restrictions in return for revenue. Guilds received exclusive rights of monopoly in return for payments to the Crown.

The ubiquitous competition among the evolving nation states was a deep underlying source of change and equally a constraint on the options available to rulers within states. It was the competition that forced the Crown to trade rights and privileges for revenue, including, most fundamentally, the granting to "representative" bodies--variously Parliament, Estates General, Cortes--control over tax rates and/or certain privileges in return for revenue. Equally, competition amongst states offered constituents alternatives--states to which they might flee or send their moveable wealth, thus constraining the ruler's options.

But at this point the stories diverge. Some bodies retained and expanded their status and provided the basis for the growth of representative government; others declined or withered away. It was the evolving bargaining strength of rulers vis-a-vis constituents that was decisive. Three considerations were at stake: 1) the size of the potential gains the constituents could realize by the state taking over protection of property; 2) the closeness of substitutes for the existing ruler--that is the ability of rivals (both within and outside the political unit) to the existing ruler to take over and provide the same (or more) services; 3) the structure of the economy which determined the benefits and costs to the state of various kinds of taxation.

In the Low Countries, for example, the productive town economies stood to gain substantually by the political order and protection of property rights provided first by the Burgundians and then by Charles V. The structure of the economy built around export trades provided the means for easy-to-collect taxes on trade but not at a level to adversely affect the comparative advantage of the trades. But the demands of Philip II led to the conviction that the economy would continue to prosper only with independence. The resistance was initiated on the authority of the States General which in 1581 issued the Act of Abjuration of allegiance to Phillip II and claimed sovereignty for the Provinces themselves.

Eventually the seven northern provinces succeeded in achieving independence and the resulting economic/political structure of Amsterdam and the Netherlands was one not only of efficient economic organization but with many of the basic attributes of political and civil freedoms. The powers of the newly independent country--the United Provinces--resided with each province and a unanimity rule meant that the States General must receive the unanimous votes of the deputations from each province (which voted as a unit).

Cumbersome as that process was, this political structure survived. The polity not only evolved the elements of political representation and democratic decision rules but equally supported religious freedom (an equally important source of friction with the Spanish Crown). The de facto policy of the United Provinces was one of toleration in the sphere of religion; it was a policy that encouraged immigration of dissenters from various parts of Europe, many of whom contributed to the growth of the Dutch economy.

In England as on the Continent, traditional feudal revenues were a declining portion of total state revenues. England's external trade provided an increasing share of the revenue, including taxes on wine, general merchandise, and wool cloth; but it was the wool export trade in the thirteenth century that was the backbone of augmented Crown revenue. Eileen Power's classic story of the wool trade28 describes the exchange between the three groups involved in that trade: the wool growers as represented in Parliament, the merchants of the staple, and the Crown. In an agreement the merchants achieved a monopoly of the export trade and a depot in Calais, Parliament received the right to set the tax, and the Crown received the revenue. William Stubbs summarized the exchange as follows: "The admission of the right of parliament to legislate, to inquire into abuses, and to share in the guidance of national policy, was practically purchased by the money granted to Edward I and Edward III..."29

With the Tudors the English Crown was at the zenith of its powers, but it never sought the unilateral control over taxing power that the Crowns of France and Spain achieved. The confiscation of monastery lands and possessions by Henry VIII alienated many peers and much of the clergy and as a consequence "Henry had need of the House of Commons and he cultivated it with sedulous care."30 The Stuarts inherited what the Tudors had sown and the evolving controversy between the Crown and Parliament is a well known tale. Two aspects of this controversy are noteworthy for this analysis. One was the evolving perception of the common law as the supreme law of the land--a position notably championed by Sir Edward Coke--and the other was the connection made between monopoly and a denial of liberty as embodied in the Crown grants of monopoly privileges. As David Sacks put it in the first volume of this series: "The concept of liberty grew in antithesis to the growth of a theory of state power which had its concrete expression in the creation of economic monopolies. The focus on the grievance of monopolies helped sustain a powerful intellectual connection between the protection of individual rights and the preservation of the commonweal."31

The Spanish Crown, in contrast, evolved into an absolutist monarchy. The nation state that emerged under Ferdinand and Isabella joined two very different regions, Aragon and Castile. The former (comprising Valencia, Aragon, and Catalonia) had been reconquered from the Arabs in the last half of the thirteenth century and had become a major commercial center. The Cortes reflected the interest of merchants and played a significant role in public affairs. Indeed, had Aragon determined the future of Spain its history would have been very different. But Castile, which had been continually engaged in warfare against Moors and in internal strife, had no such heritage of strong merchant groups. The Cortes was relatively less effective and Isabella succeeded in gaining control of unruly barons and of church policy as well. A centralized monarchy and resultant bureacracy ensued and it was Castile that determined the institutional evolution of Spain (and ultimately of Latin America, as well).

The era of Spanish hegemony was made possible by the income from the Habsburg empire and the new world treasure, but as revenue from those sources declined the Crown of necessity turned to the desperate expedients of taxation and confiscation briefly described above--with disastrous results. Economic monopolies and centralized political controls went hand in hand. The path that Spain was traveling proved durable and led to three centuries of economic stagnation and political instability which only ended with the demise of Franco in the mid twentieth century. Moreover the Spanish heritage carried over into the new world of Latin America a set of institutions and organizations that produced neither sustained economic growth nor sustained political and civil freedoms.

The divergent evolution of the Netherlands and England, on the one hand, and Spain--and France--on the other can be immediately attributed to the different bargaining strength of constitutents and rulers and the three underlying sources of that bargaining strength (the gains to constituent groups of the state taking over protection of property; the closeness of substitutes for the existing ruler; the economic structure which determined the yields to various taxes). In turn we can trace the particular geographic/economic/institutional pattern that produced the divergent conditions. Bargaining strength may be the immediate source of change but it is incomplete, and it would be misleading to ignore the complementary role played by the belief structure. Western Europe had the initial common belief structure of Latin Christendom. But that initial belief structure evolved differently in parts of Europe as a consequence of diverse experiences. In the Netherlands and England the experiences fostered the evolution of the belief structure in directions that led to modern perceptions of freedom. In contrast, Spanish experiences not only perpetuated the traditional hidalgo aversion to economic activity but also perpetuated the beliefs underlying the medieval hierarchical order.

The evolution of the belief structure in England is most succinctly captured in J. H. Hexter's introduction to the first volume of this series in which he contrasts the medieval liberties of England in 1500--"a changing body of particular claims under the protection of law for those who had them"--with the Petition of Right enacted by Parliament in 1628--a Petition which concerns "itself with freedom at the level of its foundations. Its enactment is the decisive first step in the direction of modern freedom, of liberty as we know it in our world." 32

Access to medieval liberties was determined by the hierarchical structure of the society; bondsmen--slaves, villeins, serfs, and other dependent individuals--were excluded from access. The Petition of Right, in contrast, established for all Englishmen a set of rights protected by law--a law enacted by Parliament. The changing perceptions about the rights of individuals from the medieval views of status to the seventeenth century view of Englishmen as freeborn reflected the evolution of the belief structure between 1500 and 1628. The positive combination of the belief structure with the particular conditions that existed in the Netherlands and England led to the institutional evolution of the economy and polity. Equally it fostered the intellectual changes that produced not just the Protestant Revolution but an evolving belief structure that induced behavior conducive both to economic growth and to the evolution of freedoms. It was the contrasting circumstances in Spain and (to a lesser degree) France that shaped the evolution of the belief structure in ways that reinforced their existing institutional structure and stifled both economic growth and political/civil freedoms.

Such a story takes us half way there in the evolution of modern freedom. The interplay between the belief structure and the external environment shaped the immediate policies and choices and provided a rationale to support them. But ultimately ideas of freedom took on an independent role. The rationale of the Dutch, for example, was more pragmatic than "intellectual." In the hands of individuals such as Hobbes, Locke, participants in the Scottish Enlightenment, and on the continent Montesquieu, a powerful ideology gradually evolved--one that would reshape the world. But that is another story.

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