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Introduction

American economists and political scientists first began to focus on economic development in the Third World in the 1950s. As time passed, attention shifted from the difficulties of de-colonization to fears about "dominos" after Vietnam, concerns about dependency and economic stagnation in the 1970s and 1980s, hopes for democratization after the fall of communism around 1990, and then fears about Islamic revolution and terrorism after 2001.

In all these cases, American presidents of both parties wanted immediate results. They sought advice from academics with different perspectives from their predecessors and hence who might be more successful. Each wave of advisers faced the demand to over-promise, and many responded. The first were the modernization theorists of the 1950s and 1960s who were members of the New Deal generation and favored government intervention. Progress was slow, and the failure of the Vietnam War sealed the fate of the theory.

The government then turned to neoclassical economists who developed the "Washington consensus" and demanded extremely rapid withdrawal of the state from the economy. As Alan Greenspan, chairman of the Federal Reserve Board, stated in 1997, "some … supposed" that "the dismantling of the central planning function in an economy [would] automatically establish a free market entrepreneurial system."[1] The "some" were precisely the economists who had responded to the pressure to over-promise or who had been chosen for their preexisting optimism.

Whatever the ultimate validity of the reform package of the Washington consensus, its goals clearly could not be achieved in the short and medium

1 Alan Greenspan, *The Embrace of Free Markets* (Washington, DC: Woodrow Wilson International Center for Scholars, 1997), p. 2.

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run. The results of the Washington consensus in the former Soviet Union and the developing world were highly disappointing and discredited the theory.

Many, of course, were always skeptical during the periodic waves of over-optimism. In the 1990s, both authors of the present book were critical of the Washington consensus, one on the basis of years of studying the Soviet Union and the other Latin America.[2]

The foremost skeptical economist at the time was Douglass North. At the beginnings of the 1990s, North damned what he called "the glib rhetoric of all the neoclassical economist types that have jumped into 'the reform the East Europeans game'." Then he summarized his central argument in sweeping terms in his speech accepting the 1993 Nobel Prize: "Neoclassical theory is simply an inappropriate tool to analyze and prescribe policies that will induce development."[3]

In his Nobel acceptance speech, North attributed the mistakes of neoclassical theorists to "two basic erroneous assumptions." One is "that institutions do not matter," and the other is "that time does not matter."[4] North's warning about the importance of institutions (first of all, informal ones) was widely accepted by economists and became the basis for a school of economic analysis called "New Institutionalism." By contrast, his warning about time was largely neglected, at least by those high in the policy process.

For North, "time" meant that the heritage of the past produced enormous inertia ("path dependence") in the development process. He believes that "it takes a long time" to build "the necessary prerequisites for political and economic development." In 2008, he spoke concretely of 400 years as the amount of time that is needed. Oliver Williamson, another leading economist with a similar approach, said that the change in underlying norms, customs, mores, and traditions requires "centuries or millennia."[5]

2 For Russia, see Jerry F. Hough, *The Logic of Economic Reform in Russia* (Washington, DC: Brookings Institution Press, 2001). For Latin America, see Robin Grier, "Losing Ground: Economic Growth in Latin America from 1955–1999," *Southern Economic Journal* 74 (2007), 177–203. For the argument that the neoclassical model gets almost nothing right about growth in the developing world, see Kevin Grier and Robin Grier, "Only Income Diverges: A Neoclassical Anomaly," *Journal of Development Economics* 84 (2007), 25–45.

3 Letter from Douglass North to M. D. Morris, February 24, 1991, Box 2, February 1991 folder. The Douglass North papers are located in the Special Collection Library, Duke University. They were from original. Douglass North, "Economic Performance through Time," *American Economic Review* 84 (1994), 359–68, p. 359.

4 North, "Epilogue: Economic Performance through Time," p. 343.

5 For the "long time," see Margaret Levi, "A Model, a Method, and a Map: Rational Choice in Comparative and Historical Analysis," in Mark Irving Lichbach and Alan Zuckerman,

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While those with the ear of policymakers argued that the neoclassical model must be supported by "institutions," they often used North's language simply to support the next panacea embraced by policymakers – the belief that democratic institutions were the key to stable development. This was associated with U.S. policy in countries such as Iraq and Afghanistan and also in the general policy of the World Bank. In April 2003, Thomas Friedman, the Middle East expert of *The New York Times* spoke for this view:[6]

> Iraq is the only Arab country that combines oil, water, brains, and secularism. Lebanon has water, brains, secularism and a liberal tradition. The Palestinians have a similar potential.... If Lebanon, Iraq, and a Palestinian state could all be made into functioning, decent, free-market, self-governing societies, it would be enough to tilt the entire Arab world onto a modernizing track.

Once again, expectations were disappointed. Once again, economists tried to warn against over-optimism and the importance of time. Those such as Dani Rodrik wrote about the need to adopt "second best measures" while others wrote about need to understand the difficulties of creating the rational-legal values that the sociologist Max Weber saw as the essence of a modern market. Lant Pritchett and Michael Woolcock[7] labeled this:

> the strategy of "skipping straight to Weber" – seeking to quickly reach service delivery performance goals in developing countries by simply mimicking (or adopting through colonial inheritance) the organizational forms of a particular "Denmark." We call this approach "skipping straight to Weber" because this form did not emerge from an internal historical process of trial and error and a political struggle (as it did in most European and North American countries).

eds., *Comparative Politics: Rationality, Culture, and Structure* (Cambridge University Press, 1997), p. 36. For 400 years, see John Joseph Wallis, "Answering Mary Shirley's Question, or What Can the World Bank Learn from American History?" in Stephen Haber, Douglass North, and Barry Weingast, eds., *Political Institutions and Financial Development* (Stanford: Stanford University Press, 2008), p. 92; Oliver Williamson, "The New Institutional Economics, Taking Stock, Looking Ahead," *Journal of Economic Literature* 38 (2000), 595–613, p. 596. Williamson won the Nobel Prize in Economics in 2009.

6 Thomas L. Friedman, "Roto-Rooter," *New York Times*, April 16, 2003, p. A19.

7 The authors' reference to "Denmark" does not refer to the country but rather to a typical developed country with an effective state and bureaucracy. Lant Pritchett and Michael Woolcock, "Solutions When the Solution Is the Problem: Arraying the Disarray in Development," *World Development* 32 (2004), 191–212, pp. 193 and 201. Some of the best work on historical legacies has been done by Nathan Nunn. Good examples of this include Nathan Nunn, "The Long-Term Effects of Africa's Slave Trades," *Quarterly Journal of Economics* 123 (2008), 139–76, Nathan Nunn and Diego Puga, "Ruggedness: The Blessing of Bad Geography in Africa," *Review of Economics and Statistics* 94 (2012), 20–36, and Nathan Nunn, "Historical Legacies: A Model Linking Africa's Past to Its Current Underdevelopment," *Journal of Development Economics* 83 (2007), 157–75.

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Despite the severe problems in Afghanistan and Iraq, the Arab Spring in 2011 once more produced excess optimism – and with predictable results. When North's warnings about time were not heeded during the optimism about democratization, he repeated them in different language in two books published in 2009 and 2013. The first, entitled *Violence and Social Orders,* dealt primarily with developing countries in the decades just before the transition to a democratic political system and market economy, while the second, *In the Shadow of Violence*, dealt with the earlier stage of development found in much of modern Africa, Asia, and Latin America.

In the 2013 preface to *Violence and Social Orders*, North and his co-authors were clear about the events to which they were responding: "The world continues to be full of Arab springs and, unfortunately Arab winters."[8] As David Laitin wrote in his blurb on its back cover, *In the Shadow of Violence* shows "how the World Bank's attempts to transform countries into 'open access orders' [democracies with free markets] typically yield more violence than development."

Having observed the successive waves of optimism, we became convinced that a simple warning about the importance of patience is not enough. Scholars must have concrete advice – or at least a concrete framework – that gives guidance to policymakers about what is to be done, what a patient and gradual policy would entail. For all the faults of the proponents of modernization theory, the Washington consensus, and democratization, they told policymakers what to do. In the words of the old cliché, "you can't beat something with nothing."

North has never provided a theory of change. He openly acknowledged in his Nobel acceptance speech that he "does not provide a theory of economic dynamics.… We do not have such a theory." In 1997, he said that "we simply do not know how to create efficient political markets." North added that this "is essential if we are to implement policies consistent with intentions."[9]

In 2005, North reported that his work both as an author and an editor had had a sobering effect: "As someone who has 'played God' in attempting to

[8] Douglass North, John Joseph Wallis, and Barry Weingast, *Violence and Social Orders: A Conceptual Framework for Interpreting Recorded History* (New York: Cambridge University Press, 2009); Douglass North, John Joseph Wallis, Steven Webb, and Barry Webb, eds., *In the Shadow of Violence: Politics, Economics, and the Problems of Development* (Cambridge: Cambridge University Press, 2013). The quote on the Arab springs and winters is from the 2013 preface to the paperback edition of *Violence and Social Orders,* p. xv.

[9] North, "Economic Performance through Time," p. 359. Douglass North, *The Contribution of the New Institutional Economics to an Understanding of the Transition Problem* (Helsinki: UNU World Institute for Development Economics, 1997), p. 16.

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improve performance of transition and Third World economies, I have been made acutely aware of the shortcomings in our understanding of how to set them right, which means in the first instance creating a political-economic structure that will lead to an improvement in their performance."[10]

Neither of the 2009 and 2013 books of North and his co-authors made any substantial attempt to build a theory of change except in the last 50 to 100 years of the process. In a 2014 book on the legacy of North, Claude Menard and Mary Shirley declare that New Institutionalism "needs a better theory of institutional change.… Some aspects of current institutional theory make change seem almost impossible." This point is repeated by John Joseph Wallis in his chapter in the same book.[11]

In recent decades, other scholars have also generally followed North's example in concentrating on the period of the final transition to a modern society. This, however, constitutes only 10% to 15% of the time North and Williamson say is necessary. We decided to concentrate on the more neglected 85% to 90% of the process – the period we call "pre-industrial." This is a crucial period because so many developing countries have progressed no further.

Our research design was based directly on North and Williamson's insight about time. If the development process requires centuries or millennia, a good research design should cover this length of time. We thought that a comparison of at least one "good" case and one "bad" case was required, cases that were truly comparable. They should be subject to the equivalent of loose controls by being in the same geographical area and in the same period with a 1000-year sweep. This history should be well documented in both cases in the scholarly literature that the authors could read.

For an American, Europe is the obvious choice of locale, and England is the obvious choice for the "good case." The most comparable "bad" case is Spain. In AD 800, both England and Christian Spain along the Bay of Biscay were sheep-growing areas dominated by small warlords. The beginning of the English and Spanish states in their most primitive form can reasonably be dated to the same time: the Norman invasion of William the Conqueror

10 Douglass North, *Understanding the Process of Economic Change* (Princeton, NJ: Princeton University Press, 2005), footnote 5, pp. 67–8.

11 Claude Menard and Mary M. Shirley, "The Contribution of Douglass North to New Institutional Economics," p. 28, and John Joseph Wallis, "Persistence and Change in Institutions: The Evolution of Douglass North," p. 48, in Sebastian Galiani and Itai Sened, eds., *Institutions, Property Rights, and Economic Growth: The Legacy of Douglass North* (Cambridge: Cambridge University Press, 2014).

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in 1066 and Garcia Sanchez's formation of the Leon-Castilian "kingdom" (a loosely knit coalition of small warlords) in 1038.

Both England and Spain (Castile) had long been Catholic in the mid-1000s and were to remain so for another 500 years. Both exported wool in increasing amounts to Flanders, and both were heavily engaged in foreign trade until the late 1500s. Both created a great colonial empire in the New World that depended on secure transportation across the Atlantic Ocean.

Moreover, the economic development of Spain and England was closely linked. Spain began with a command of the sea that prevented English colonization in the 1500s, and the Tudor creation of an English navy and merchant fleet was the key event that led to the virtual collapse of the Spanish Empire in the 1600s. The Bourbon re-creation of the Spanish fleet in the 1700s restored their control over the Empire. Seemingly, the two countries should have followed similar paths of development, but they did not do so.

The use of England and Spain as our two main cases made it natural and easy to add two more cases: the United States and Mexico. Indeed, one of the two authors had a long special interest in Mexico and the other in the United States. We began the study with a special interest in the role of the colonial legacy in explaining why the United States developed much more rapidly than Mexico. As a result, we decided to end the book roughly a decade after the United States and Mexico became independent. This meant it covered the period from 1000 to roughly 1800 in the American case and 1830 in the Mexican.

But Mexico was a colony for 300 years and the United States for 170. Our acceptance of North and Williamson's insight about time forced us to trace their "colonial tradition" well back into English and Spanish history. Indeed, we came to realize that the different consequences of Henry III's conquest of London in 1265 and Alfonso X's conquest of Cadiz in 1262 made the 1260s a key moment in the colonial legacy to the two countries.

Since the colonial experiences of England and Spain were both heavily shaped by the changing relative capability of their armed merchant fleets, the book provides an interesting – and for economists, quite fresh – sub-case study of the role of armed merchant ships in "peaceful trade" and their crucial importance in commerce, economic development, and domestic politics. We focus on two elements of English domestic political history that are ignored in the American economic literature: the critical role of the Hanseatic League fleet in its late medieval development and the merchant-naval alliance in English politics in the 1600s and 1700s.

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The intellectual assumptions of this book rest on the failure of Douglass North and the "New Institutionalists" to put forth a multi-century theory of change. North himself implicitly agreed that the insights of New Institutionalists were not in themselves enough for such a theory. He sought the answers in modern psychology, but he did not find that literature sufficient to solve the problem.[12]

This suggests to us that insights from still other intellectual traditions need to be added to those of New Institutional theory to move in the direction of a theory of change. We think that the place to start is with the work of two great scholars in the 20th century who became central figures in sociology and political science: Max Weber and Mancur Olson.

Douglass North argues that a modern society depends on the development of the appropriate norms, values, mental images, and ideologies (informal institutions, in his phrase). Yet he never says anything about the content of either the informal institutions that are needed or those that have to be overcome. Max Weber's *Economy and Sociology* and his *Politics as a Vocation* concentrate on the difference between the values of village and tribal society on the one hand and those of modern society on the other.

As a result, Weber is a perfect supplement to North. This is particularly the case, as Pritchett and Woolcock point out, because many development economists implicitly think in terms of "skipping straight to Weber" – that is, his image of modern values – without giving their intellectual assumptions much thought.

Mancur Olson was a neoclassical economist who applied neoclassical assumptions about human motivation to individual behavior in the political sphere. As a result, he concluded that it was almost never rational for members of large groups to engage in large-scale collective action simply because they favored the achievement of a collective goal. He argued that such collective action depends on compulsion or selective side payments (rewards that only the individual receives).

Since the role of compulsion (the military) and selective side payments (the tax collection necessary to provide them) are almost never discussed in the social contract and contractarian analyses, Olson naturally was a sharp critic of these arguments that are at the heart of New Institutionalism. Indeed, Olson had been stimulated to develop his theory of the state in the early 1990s by his negative attitude toward the social contract embedded in Douglass North and Barry Weingast's iconic

12 For a summary of the work, see North, *Understanding the Process of Economic Change*, pp. 23–64.

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1989 article on the Glorious Revolution of 1688: "Constitutions and Commitment."[13]

Olson had "Constitutions and Commitment" specifically in mind when he wrote that voluntary collective action simply "*cannot* obtain the gains from a peaceful order [of a state]." Instead, Olson argued, the ruler is the person who "can organize the greatest capacity for violence."[14] North has had a negative attitude toward rulers and bureaucracies, but Olson reminds us that violence is needed to control violence and to provide the framework for cooperative action within society and the economy. Olson, thereby, provides us with insights into a mechanism of change that is quite absent in North's work.

Both Weber and Olson analyzed the earliest forms of society and the state and also the character of modern society. Unfortunately, neither of them analyzed the long period of transition between the two periods. Neither explained how the change takes place. This intermediate period is the main focus of this book, and we think that Olson's analysis leads to a series of new insights – hypotheses, if you wish – that are not found in the literature of American economists.

The fundamental historical question of this book is why it took England so many centuries to develop an effective state and market and why Spain required 200 years longer. A collective action theory that focuses on compulsion and selective side payments gives far greater importance to the direct or indirect impact of factors including military force on key events that mythologists want to discuss in other terms. We suggest – and document at some length – that this includes the three English regime changes in the 1640s, 1660, and 1688 and the Constitutional Convention of 1787 in the United States.

In the last section of this chapter, we discuss those aspects of Weber's and Olson's analyses that we consider most useful to integrate with North's analysis to answer North's question: Why does time matter? Why does development take so long and how is positive change accomplished?

North's 2009 *Violence and Social Orders* and 2013 *In the Shadow of Violence* move partially, but only partially, toward Olson's analysis. We are able to compare these recent books with North's earlier work and with his archived correspondence from the 1970s, 1980s, and 1990s in order to clarify more clearly the difference between a social contract and a collective approach.

[13] Douglass North and Barry Weingast, "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth Century England," *Journal of Economic History* 49 (1989), 803–32.

[14] Mancur Olson, "Dictatorship, Democracy, and Development," *American Political Science Review* 87 (1993), 567–76, p. 568.

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Absorbing the Meaning of "Time" in Development

Probably the most difficult aspect of this book is seemingly the simplest, namely, how to ensure that readers have some understanding – or really some feel – for the real meaning of the phrase "hundreds of years or millennia." Even a year or two of a crisis seems an eternity when we are forced to live through it, but decades seem like years and centuries seem like decades when we look at the past. So do millennia when we talk about the third millennium BC or the like.

As a result, we begin this book with an effort to illustrate this most basic of facts. We use English history as an example, primarily because its history is more familiar to most readers of this book than the history of Spain. In addition, even though we ask why economic development was much slower in Spain than in England, the more basic question is why development took such an incredibly long period in the "good" case of England.

The Norman invasion of 1066 is certainly the point at which to start, all the more since the "English" state and culture are really Franco-English. Consider the chronology in England after the Norman Conquest in 1066. The Magna Carta was signed in 1215; London was established as a capital of a city-state in 1337; London imposed control over all of England in 1485 (really the early 1500s); the Glorious Revolution took place in 1688 and the partial move toward the democratization of Britain in the Reform Act of 1832.

If we do some simple mathematics, we find that the period of time between each of these events was more or less 150 years. The American Civil War was 150 years ago, but it seems part of the ancient past. There were over five such periods between 1066 and 1832 in England. It is harder to believe that the Glorious Revolution occurred 576 years after the Magna Carta of 1212, a period 50 years longer than the time from Columbus's voyage to the present.

Let's think hypothetically. Kabul has still not established control over the interior of Afghanistan, even as the capital of a confederation. But imagine optimistically that that occurs by 2020. The victory of Henry VII in 1485 was the equivalent watershed event in English history. If Afghanistan is on the English time path, it will have its Glorious Revolution in 2323 and full democracy in 2437. Obviously the change in contemporary Afghanistan will come much faster because of the transformation in technology and education, but these dates help us to understand just how slowly England evolved.

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Or let's look at the period from 1066 to 1776 in a different way. It was 237 years from 1776 to 2013. All of us are quite aware of the enormous changes that have taken place in the United States socially, economically, and politically since the American Revolution. It turns out that the period from 1066 to 1776 can be divided into three periods, *each* exactly as long as that from 1776 to the present. As much change – or almost as much change – occurred in England during each of these three periods as occurred between 1776 and 2013.

The first of the three periods extended from the Norman Conquest in 1066 to 1302. In the first 60% of the period, the Norman kings and lords lived primarily in France. When the kings came to England for visits, they were itinerant rulers who received most of their revenue from "rent" from peasants living on their land and from looting. King John, who signed the Magna Carta in 1215, was the last of these French kings.

John's son, Henry III, was the first king to identify himself fully with England and its pre-Norman past. He disregarded the Magna Carta by defying the lords and gained full control of London and the surrounding area in 1265. Nevertheless, Henry III and all "English" kings until 1387 still spoke French as their native language.

As one of Henry III's descendants began to establish himself as the warlord of the city-state in London (really in Westminster and the Windsor Castle), the other English warlords consolidated their positions in their castles in the countryside and, of course, retained their military force. The political-economic system in 1300 is rightly called "military feudalism" (warlords with military force, but without classic serfdom).[15] We call it a pre–nation-state.

The second period of 237 years stretched from 1303 until 1539 and also featured drastic changes. In 1303, London still would not be a real capital for 34 years, and a permanent large wool export tax would not be introduced for more than 40 years. The latter was the first major tax that the kings were able to collect other than rent from their own estates. Yet they did so only by allying with the greatest naval power of the time, the Hanseatic League.

The major achievement of the king before 1485 was the gradual creation of an effective government and economy in London, but its economy was based almost entirely on monopoly guilds. The king governed London quite well through a city council composed largely of guild leaders. That is, the king still did not have the military force to control the lords of the interior,

[15] For a discussion of military feudalism, see Charles Wilson, *England's Apprenticeship, 1603–17*, 2nd ed. (London: Longman, 1985), pp. 3–4.

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