Institutions and economic growth: The rise, spread, and limits of sustained economic growth

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The Economics of Growth

- The basic economic growth model assumes that outputs are a function of inputs and technology:

- $Y = aL^B K^{B-1}$

- Since inputs move slowly, as does technology, defined either as techniques or institutions, then economic performance should be relatively smooth over time.
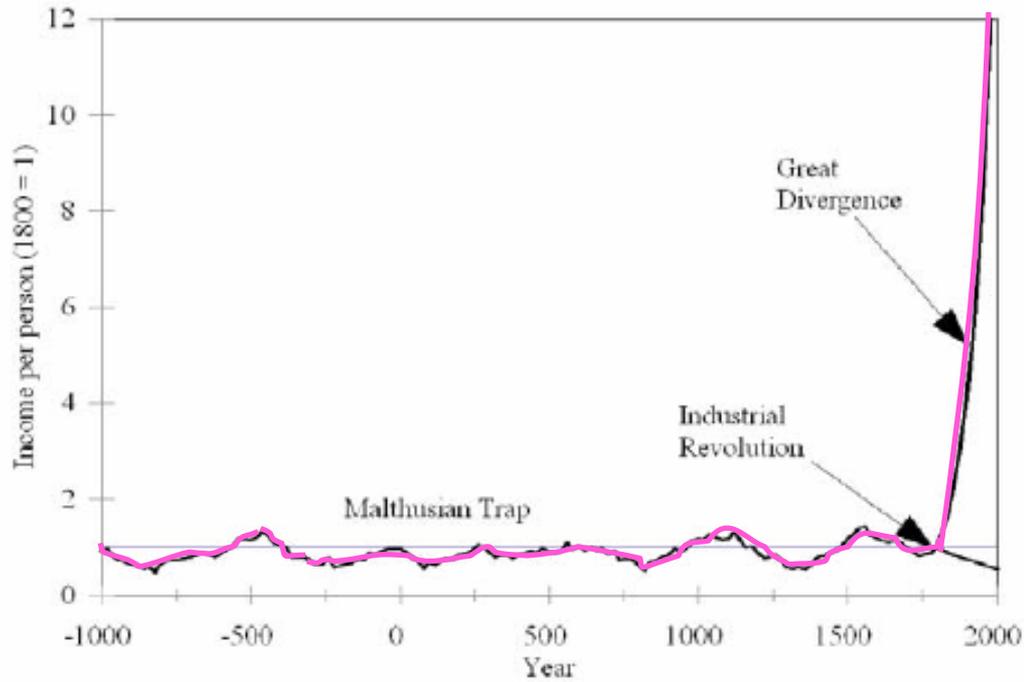
Greg Clark, *Farewell to Alms*

Figure 1.1 World Economic History in One Picture

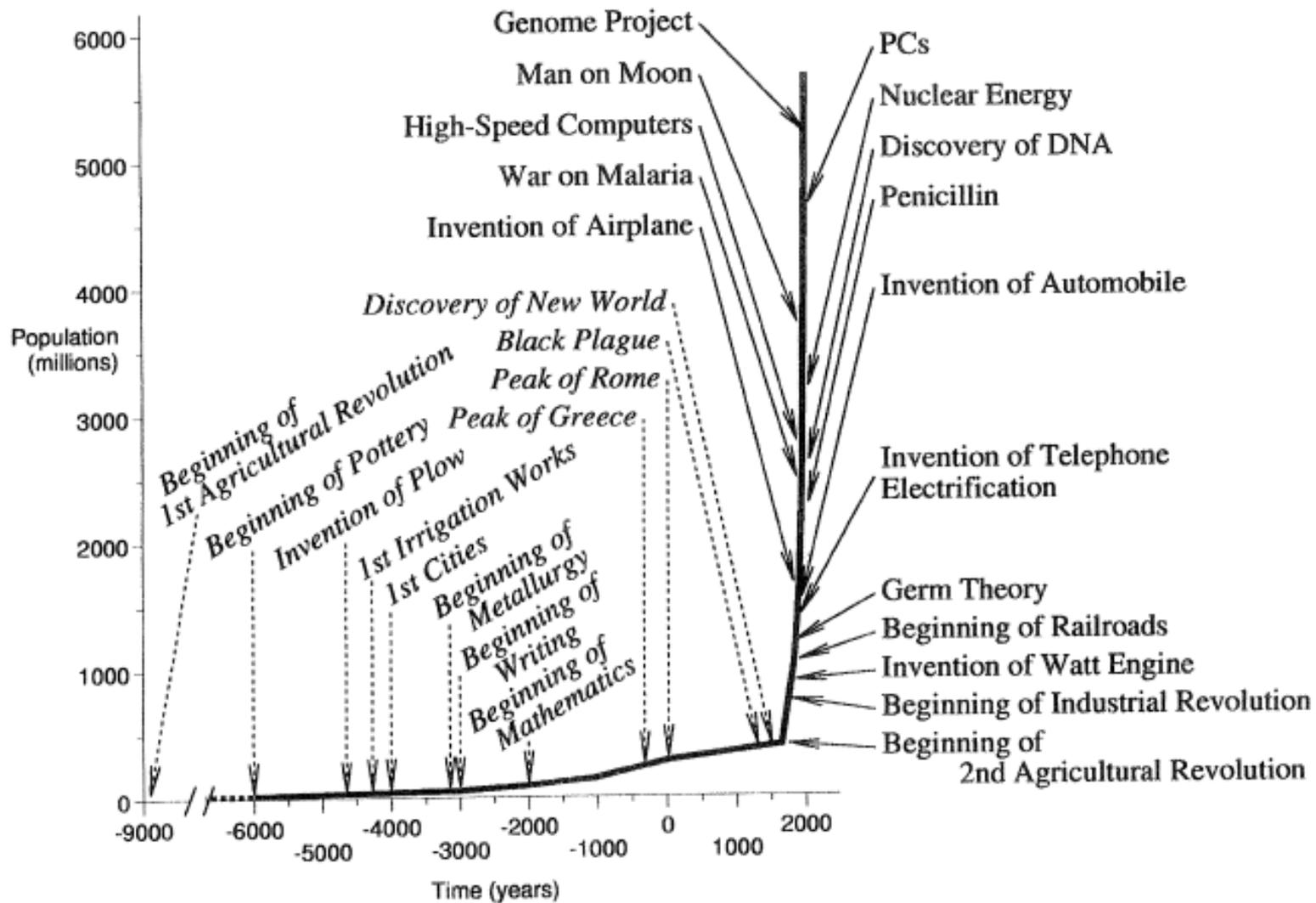# But what about Malthus? What was happening to world population?

FIGURE 1. THE GROWTH OF THE WORLD POPULATION AND SOME MAJOR EVENTS IN THE HISTORY OF TECHNOLOGY

Source: R.W. Fogel, "Catching Up with the Economy," *AER* (1999)

- Something obviously changed about 200 years ago.

- Before then, the long run rate of per capita income growth was very close to zero, and most increases in income were taken up in the form of population.

- Do rich countries grow faster than poor countries?

Per Capita Income in 2000	Average Positive Growth Rate	Average Negative Growth Rate	Percent Positive Years
Over $20K No oil	0.0388	-0.0233	0.84
$15 to $20K	0.0559	-0.0425	0.76
$10 to $15K	0.0527	-0.0407	0.71
$5 to $10K	0.0525	-0.0459	0.73
$2 to $5K	0.0539	-0.0475	0.66
$.3 to $2K	0.0537	-0.0538	0.56

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Shrink Theory

- Over the last 60 years, rich countries have not grown faster because they grow faster when they are growing, they actually grow more slowly,

- But rich countries shrink more slowly and shrink much less often than poor countries.

- The poorest countries shrink as fast as they grow, and they shrink in 44% of all years.

Violence and Social Orders: A Conceptual Framework for Interpreting Recorded Human History

Douglass North, John Wallis, and Barry Weingast, Cambridge University Press, 2009.

The Concept of Social Orders

- The concept of the *social order* provides:

	- A framework for understanding how violence is contained.

	- A framework within which we can simultaneously understand the operation of the political, economic, and other social systems.

The Logic of the Natural State

- The Natural State political system creates economic rents through limited access and then uses the rents to sustain order.

- The Natural State is a solution to endemic violence.

Natural States/Limited Access Orders

- Natural states create incentive-compatible agreements among powerful individuals and groups by recognizing the privileges of each individual to control valuable resources, activities, and organizations.

- The interaction of these incentives both orders the dominant coalition and limits the use of violence.

- All natural states are limited access orders.

The Nature of Rents

- By enabling the formation of larger and better coordinated groups and organizations, the natural state creates rents from increased output and productivity through greater coordination and scale.

- This is not about maximizing the rents the rich and powerful receive, it is about creating rents that are affected by violence or lack of coordination, and therefore serve as means of limiting violence and promoting coordination.

The Logic of the Open Access Order

- Open access orders control violence by consolidating control of violence in a single or small number or organizations: military and police and placing control of the military in a political organization.

- The subjecting control of the political organization to political and economic competition through open access.

Three pieces

- Consolidated control of military and police (a Weberian state)

- A competitive polity that controls the military, but is (as a result) potentially very dangerous

- A competitive economy capable of disciplining the polity.

- Open access – the ability to form organizations at will – is the key to sustainable political and economic competition and, therefore, to the dynamics of the whole social order.

The Idea of the Double Balance

- Open access requires that access to economic and political organizations be open, so entry in economics disciplines the political process, and entry into politics disciplines the economic process. In natural states, limited access to economic and political organizations is similarly self-enforcing.

- The idea of a double balance is that economic and political arrangements must be consistent with one another, and if they are not, dynamic forces will be set in motion to "restore" (or affect) the balance.

The Double Balance

- The close connections between economics and politics in developing countries is often perceived as corruption, when it is an inherent part of the social order.

- The seeming independence of economics and politics in developing countries is something of an illusion, since it ignores the deep connections between the two in an open access society.