Government, Institutions, and Economic Growth in Europe, 1700-1870

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Economic historians argue that the nature of a society's institutions is important for economic growth.[1] By 'institutions' they mean rules that regulate human behavior and are enforceable. Some of these rules are customary and can be privately agreed to and enforced, for example, by reputation. However, most of the work on the role of institutions in economic growth discussed by economic historians focuses on the formal institutions that are publicly created and enforced by governments. Historians especially highlight the importance of the role of secure property rights in promoting economic growth. Since Britain was the most successful economy during the period, historians have long pointed to the importance of its constitutional settlement of known as the Glorious Revolution in 1688-89, which created a constitutional monarchy with secure property rights. This argument ignores the economic success of the earlier Italian city-states and the Dutch Republic of the early modern period. It is important to keep in mind that in 1700 the state and nation in most places were very different things, while by 1870 sovereign states and the nation coexisted in most of Western Europe. To the east, the Russian, and Ottoman empires survived, although much weakened, until the early 20th century. During the early modern period, and especially after the Peace of Westphalia in 1648, many states in Western Europe had become sovereign national states. These states created national administrative, fiscal and military institutions. Most of these national states claimed to be absolutist and sought to create efficient centralized governments. Absolutist states strengthened their control over the nation by weakening traditional alternative sources of power, such as the Church, the nobility, and regional assemblies and courts. They especially attempted to centralize taxation and became what historians have called 'fiscal military states.'

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[1] This essay relies on the excellent summary of this topic by Dan Bogart, Mauricio Drelichman, Oscar Gelderblom and Jean-Laurent Rosenthal, "State and Private Institutions,' in Stephen Broadberry and Kevin O'Rourke, eds., *The Cambridge Economic History of Europe,* Vol. 1: *1700-1870*, (2010). Pp. 70-95.

There were several exceptions to the growth of centralized absolutism in early modern Europe. One was Poland, where the landed nobility succeeded in maintaining local control and a central government failed to develop. The result was Poland's division by its neighbors in the late 18th century. The other exceptions to the growth of absolutism were Britain, the Dutch Republic and the Swiss Confederation. The Dutch Republic was a result of the revolt of the Low Countries against Spain from the late 16th to the mid 17th century. The Republic was ruled by its merchant class and created a decentralized but effective military fiscal state and became Europe's most successful economy until the early 18th century. In England, which became the United Kingdom in 1707 when it combined with Scotland, the constitutional settlement of 1689 resulted in the creation of a powerful and centralized fiscal-military state governed by a partnership between the Crown and Parliament. A representative Parliament, a strong executive, professional bureaucracy and financial institutions were developed to serve the interests of the state and became what has been called '"the sinews of power."[2] Many of these innovations were in fact imported and adapted from the Dutch Republic.

The classic example of an absolutist state in Europe was the *Ancien Régime* of France in which many of the state's government departments became the private ownership of elites. When reform efforts failed in the late 18th century, the French Revolution swept these, as well as surviving local and regional institutions, away and set out to create a representative national state with a strong central government. Napoleon completed this task through an autocratic central government, which abolished all provincial and legal privileges. His most lasting innovation was the introduction of a reformed code of civil law. The French Revolution had already created a national citizen army that fully integrated military forces into the fabric of the national state. Napoleon's conquests spread the codification of civil law and nationalism throughout Europe. By 1870, with the exception of the Russian and Ottoman empires, all European states had constitutional governments, ranging from strong central and monarchical controls to those in which Parliaments had ultimate responsibility for governing the state. Since the two most successful economies in early modern Europe, Britain and the Dutch Republic, were also those that provided the greatest political and economic freedom, as well as security of property and the

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[2] John Brewer, *The Sinews of Power: War, Money and the English State* (1989).

ability to extract a high level of taxation from its citizens to fund its military and provide infrastructure, a general belief began to develop that a measure of political and economic freedom was essential for economic growth. Moreover, the industrial revolution, which first took place in Britain, rapidly spread to areas in Europe and America that had representative political institutions and relatively efficient governments. While there may be no direct cause and effect between modern economic growth and relatively free political institutions, as can be seen today by the experience of China, for example, it does appear that the origin of modern economic growth in Western Europe was related to relatively free political institutions *and* the development of relatively efficient national states during the period 1700 to 1870.

During the period 1700 to 1870, European states raised revenue almost entirely in order to fight wars to expand or defend themselves. While the per capita taxes raised were higher in the Dutch Republic and in successful city-states such as Hamburg, the table below shows that the amount of revenue raised by Britain and France made them Europe's great powers in 1765. In the 1740s, government revenue in he Dutch Republic was 14% of income. Between 1665 and 1800, total tax revenue rose in from 3.4% of GDP to 12.9% in Britain, while in France taxes fell from 9.4% in the early 18th century to 6.8% in 1788.

Annual revenue of European states around 1765, in pounds sterling,
and estimated share of direct taxes in total fiscal revenue in 1770.

Country	Annual revenue (c. 1765)	% share of direct taxes (c. 1770)
France	12,350,000	49
Great Britain	9,702,172	24
Habsburg monarchy	3,972,749	51
Spain	3,944,000	10
Holland	2,417,807	43
Prussia	2,104,077	32
Sweden	1,734,108	n.a.
Denmark	1,029,918	49
Bavaria	476,667	46
Austrian Netherlands	244,141	0
Hamburg	184,223	30
Dutch Republic	117,700	0

Source: Bogart, *et al*, p. 78.

Taxes can be direct, such as on real estate, revenues from royal land, or the sale of monopoly rights, or indirect, such as customs duties and excise taxes on consumers. In general, it was easier to increase revenue from indirect than direct taxes. Part of the problem was that it was harder to collect direct taxes since in most countries tax collection was still in the private hands of tax farmers or local authorities. Efficient fiscal centralization required a professional bureaucracy and the consent of the elites. Britain's success in taxing its citizens was in large measure due to its constitutional form of government. The wars of the French Revolution and Napoleon required an unprecedented level of taxation, which also resulted in the centralization of taxation in many states. There was even some experimentation with income taxes during this period. Nonetheless, by 1870 only about 20 to 40% of revenue came from direct taxes. After the unprecedented expense of the Napoleonic wars, Europe went back to a modest level of taxation. By 1870 most central government taxation was at about 10% of GDP, which was not very different from the level of taxation a century earlier. In some countries, taxes actually declined. In France taxes went from 10.4% of GDP in 1820 to 6.9% in 1870. Dutch taxes went from 14% of GDP in 1840 to about 8% in 1870. Part of this decline was due to the fact that economic growth was faster after 1815 then before and thus a similar tax rate produced more revenue. Since taxes were chiefly levied for the military, fewer European wars after 1815 meant that less revenue was needed since European central governments had not yet begun to provide such public goods as education, social welfare or civil infrastructure.

Another important component of economic institutions that had an impact on economic development is business law. Some have argued that historically the common law legal framework of Britain has been friendlier to economic development than the Roman law, and the subsequent Napoleonic codes, upon much of business law was built in France, southern Europe and the European states created out of the former Ottoman empire, while Germanic and Scandinavian law falls somewhere in between. This argument is problematic since the crucial area of commercial law that allowed the existence of modern corporations were passed after 1850, by which time industrialization was well underway. Medieval canon law did not look kindly initially on credit, but the legal problems of debt had been solved well before 1700 in Christian and Jewish communities. Individuals could issue and endorse letters of exchange and commercial notes throughout late medieval Europe and the Ottoman Empire. They could borrow money by mortgaging land and other private property and sign private obligations. Buying shares in business enterprises, or equity, was more problematic. Thus, most businesses owned by more than one individual or family were legal partnerships, which did not enjoy limited liability. The exceptions were some industries, which required very large amounts of capital, such as mining and shipping enterprises, and most spectacularly, the great overseas trading companies, such as the Dutch and English East India companies. These joint-stock companies operated under the limited liability of losses to its members in proportion to the equity each held. These companies, however, were generally chartered by the state, operated as a monopoly, and restricted equity ownership to particular individuals in a locality or state.

Although there were some efforts in the 18th century to further develop equity markets, the great European financial crisis of 1720-21, known as the South Sea Bubble, produced legislation that prevented the extension of the principle of limited liability to ordinary businesses. On the Continent the French Revolution brought an attempt to create a unified code of civil law that would regulate private and business transactions. Under Napoleon a new civil code was introduced in France and versions of this, or new civil codes, were subsequently adopted in many European states, as seen in the table below. These new codes of business law gradually made the extension of credit more secure during the 19th century

Business law reform in Europe in the 19th century

Country	Codes via French occupation or annexation	Date commercial code adopted	Date general incorporation enacted
Austria-Hungary	No	1811	1899
Belgium	Yes	1851	1873
Ireland	No	None	1857
Italy	Yes	1865	1883
France	n.a.	1807	1867
Germany	Parts	1861	1870
Greece	No	1827	n.a.
Netherlands	Yes	1838	1863
Prussia	No	1807	1870
Portugal	n.a.	1833	1888
Russia	No	1836	Not before 1917
Spain	Yes	1830	1869
Serbia	No	n.a.	n.a.
Sweden	No	n.a.	1895
Switzerland	Yes	n.a.	n.a.
United Kingdom	No	None	1857

Source: Bogart, *et al,* p. 85.

Business corporations have their roots in impersonal associations of local government, such as towns and provinces, or in organizations that provided services, such as by guilds, charities or governments. Modern corporations have three main attributes: they are legal persons and could thus could sue and be sued; they have a lifespan independent of its individual members; and they could delegate management. Historically, they rarely enjoyed limited liability, but, as already noted above, this changed with the founding of the great government chartered trading companies. During the late 18th century, many new corporations were founded as public-private partnership to develop infrastructure such as canals, turnpike roads, harbors, and, from the 1830s, the railroads. It was not until 1857 that business law reform in Britain granted limited liability for ordinary business corporations, and this was soon followed by similar legislation throughout most of Europe.

The role of the state in providing infrastructure for business was one of the key areas in which political, fiscal, and legal reform came together in the promotion of economic growth. Large capital intensive public utility projects, such as canals, roads, railways, and later the provision of water and sewage facilities, required the power of the state to provide rights of way across private property, government financing or aid, and in some cases logistical and organizational support. During he Middle Ages, the building and maintenance of dikes in Holland was done by specially constituted government organizations that could requisition labor and materials. In 1700 most European roads were locally built and maintained using conscripted labor or tolls. The role of government in the origin of the turnpike toll roads in Britain has been traced to military road building in Scotland to pacify the Highlands after the Jacobite rising of 1745. During he late 18th and early 19th centuries, Parliament used the experience of the military's road-building to create a British trunk roadway system, consisting of regulated turnpike trusts. By 1840 there were over 30,000 km of turnpike roads in England and Wales suitable for use by large wagons and fast coaches. Jo Guldi has argued that this constituted the invention of the 'infrastructure state.'[3] In France and Spain local roads were the responsibility of local governments but the central government funded the building of a system of royal roads so that by 1840 there was a national network of royal trunk roads of 34,000 km in France. The table

[3] Jo Guldi, *Roads to Power: Britain Invents the Infrastructure State*, (2012).

below shows the number of kilometers of roads per capita and per square kilometer in selected countries.

Road Policies, 1700-1840

Country	Summary of road policy	Road km per capita (000s) c. 1840	Road km per sq km c. 1840
England and Wales	Mixture of local and turnpike network	1.98 turnpike 7.54 local	0.13 turnpike 0.49 local
Southern Netherlands/Belgium	Mixture of local and turnpike network	1.22 turnpike local n.a.	0.17 turnpike local n.a.
France	Mixture of local and state financing	1.0 royal 0.88 local	0.05 royal 0.05 local
Spain	Mixture of local and state financing	0.6 royal local n.a.	0.015 royal local n.a.

Source: Bogart, *et. al.*, p. 89.

The building and maintenance of waterways, such as canals and improving rivers to make them navigable, was another important form of government involvement in the building of infrastructure. During the 17th century the government of the Dutch Republic financed and organized the building of an extensive national waterway system, which made possible the famous *trekvaart* system that consisted of a network of regular scheduled barges throughout the country and constituted the world's first mass transit system. The canals were owned by cities, such as Amsterdam, Haarlem and Utrecht, with the co-operation of the provincial government of Holland. By 1700, the Dutch had the most extensive waterway system in Europe, which included over 650 km of canals[4] The provincial government of Holland also made possible the privately financed drainage projects that created the polders, which became characteristic of the country. Indeed, modern political scientists use the term 'polder politics' to describe a political tradition of seeking consensus in government because the management of a countryside below sea level required government control and private participation. England attempted to emulate the Dutch Republic in the 17th century but competition between the King and Parliament made it difficult to acquire property rights and organize large-scale canal building until after the constitutional

[4] Jan de Vries, *Barges and Capitalism, Passenger Transportation in the Dutch Economy, 1632-1832* (1978).

settlement of 1689. During the great age of English canal building, which was mostly financed with private capital but organized by canal corporations and Parliamentary legal support, over 7,000 km navigable waterways were built by 1840. In France a much smaller network of canals were built in the 17th and 18h centuries with private financing and by securing privileges from the king or Provincial Assemblies. During the late 18th century, the central government financed a few waterway projects, but it was not until the 1820s that a system of public-private partnerships began building a national canal system. During the 1870s the French government bought out the canal companies so that by 1880 the French waterway system was government owned. Belgium followed the Dutch model but by the 1860s began to bring its waterway network under government ownership. Germany and Russia made few waterway improvements before 1870 but municipalities generally made some improvements in Germany before that time. After German unification, the Imperial government took over the ownership and financing of major waterway projects.

Waterway policies 1700-1870

Country	Summary	Waterway km per capita (000s) c. 1850	Waterway km per sq km c. 1850
England and Wales	Private river and canal network	0.40	0.029
Dutch Republic/Netherlands	Municipal financing and ownership	0.53 (1830)	0.04 (1830)
France	Mixture of public and private participation	0.23	0.006
Belgium	Initially mixture of provincial and private ownership, later state-owned	0.36	0.05
Germany	State-owned network	0.07	0.005
Russia	Mostly state-owned network	0.01	0.0001

England, 7,200 km; Dutch Republic, 1,400 km in 1830; France, 4,170; Germany, 2,500 km; Russia, 500 km; Belgium, 1,600 km.
Source: Bogart, *et. el.*, p. 91.

During the nineteenth century, the largest investment in infrastructure in most European countries was the construction of a railway network. While most states left railroad planning, construction and operations to private firms, many subsidized their development and some even turned to state ownership. Until 1870 The United Kingdom and France had the highest degree of private railway ownership. In Britain, Parliament enacted legislation for companies to build railroads, which allowed them to secure a right of way. In France, a government department, Ponts-et-Chaussées, did the railway construction planning and engineering. The state provided ninety-nine year leases to private railway companies and guaranteed dividends on loans for new construction. By the 1860s government guarantees on railroad loans and dividends became common in Europe. Some states also built their own railways for political and military reasons. After 1870, many states nationalized their railways.

Railroad policies in Europe, 1825-1870

Country	Summary of railroad policies	Railroad km per capita (000s) c. 1870	Railroad km per sq km c. 1870
United Kingdom	Private ownership with no subsidies.	0.80	0.081
France	Private ownership with subsidies.	0.46	0.080
Spain	Private ownership with subsidies.	0.32	0.011
Portugal	Private ownership with subsidies.	0.16	0.008
Austria-Hungary	Private ownership with subsidies.	0.27	0.015
Russia	Mostly private ownership with state subsidies. Companies own 90% of track km.	0.17	0.002
Italy	Mostly private ownership with state subsidies. Companies own 90% of track km.	0.22	0.020
Netherlands	Shift from private to state ownership Companies own 43% of track km.	0.25	0.027
Denmark	Shift from private to state. After 1860 the companies own 36% of track km.	0.42	0.020
Norway	Shift from private to state ownership. Companies own 19% of track km.	0.20	0.001
Germany	Mixture of state and private from the start. Companies own 56% of track km.	0.47	0.035
Sweden	Mixture of state and private from the start. Companies own 61% of track.	0.69	0.006
Belgium	Mixture of state and private from the start. Companies own 69% of track km.	0.55	0.095

United Kingdome, 25,400 km; Netherlands, 900 km; France, 16,700 km; Belgium, 2,800 km; Germany, 19,100 km; Norway, 367 km; Italy, 6,000 km; Austria-Hungary, 9,500 km; Spain, 5,400 km; Portugal, 694 km; Russia, 11,200 km; Denmark, 750 km; Sweden, 2,860 km. Source; Bogart, *et. al.*, p. 93.

Most modern economic historians argue that in such areas as political and fiscal institutions, tax policy, business law reform, and the provision of infrastructure open to the public, such as road, waterways, and railways, European central governments played an important role in promoting economic development between 1700 and 1870, despite the fact that they raised about the same or a lesser percentage of GDP in taxes in 1870 than in 1700. While the specific policies promoted by governments varied greatly and were dependent upon he particular circumstances, central governments generally increased their role in shaping economic policies, which reduced local and provincial particularism, and provided the national economies with greater market integration. Many have argued that the Glorious Revolution in England limited the power of government and linked this to its successful economic growth. However, even in Britain, the government played a crucial role in providing the country with economic institutions and policies that had a considerable impact on its economic development. In the Dutch Republic, which was a confederation with a weak central authority, the state played a crucial role in integrating its economy, and the provision of infrastructure and military power to promote and protect its economic growth well into the 18th century. On the continent, and especially in central and eastern Europe, where there was more political fragmentation, governments played an even larger role in shaping common economic institutions by the late 19th century. The economic success of Western Europe's success by 1870 can not simply be attributed to a policy of laissez faire, as has often been argued in popular discourse, but was in part due to the development of economic institutions that promoted economic growth, including the role of governments.