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WHY HAS THE ECONOMIC PERFORMANCE OF SPANISH-SPEAKING AND ENGLISH-SPEAKING COUNTRIES BEEN SO DIFFERENT?

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RAICES INSTITUCIONALES DE LA POLITICA ECONOMICA COSTARRICENSE

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Part One examines how organized interests have a large impact on economic performance, particularly when they influence policy with respect to international trade and foreign investment. The difficulty in organizing large groups, the proliferation of small groups over time, and such groups' pursuit of policies that are in their own interest but contrary to those of society as a whole are emphasized.

The commercial and industrial revolutions in European countries are traced in large part to a reduction in trade barriers and guild restrictions, largely from the creation of nation-states and free-trade areas, and it is noted that most new types of business developed in new cities and suburbs that were relatively free of established commercial interests. Differences between the postwar growth rates of Continental and English-speaking countries are attributed to the greater wartime disruption of organized interests on the Continent, as well as to lower levels of protection among the EEC countries, which effectively reduced the ability of localized interests to cartelize and restrict trade.

Part Two examined the different ideas that, because of historical accidents, emerged in Britain and Spain in the seventeenth century and that have continued to play a considerable role in explaining the difference in economic performance between the English-speaking and Spanish-speaking countries. Seventeenth century Spain passed mainly illiberal ideas on to the Spanish colonies. These ideas have made the Spanish-speaking countries more susceptible to protectionism and economic nationalism than the English-speaking nations have been. These ideas have also handicapped the advance of democracy in the Hispanic world.

Protectionist barriers encourage special interest organization, and special-interest organizations generate not only more protectionism, but many other types of special interest legislation and regulation as well. If the prevailing ideas about what economic policy should be are not sound, the organized special interests do more damage than they would otherwise have done.

If it is an unlucky inheritance of ideas from Spain, rather than any alleged deficiencies of the resources or peoples of Latin America, that explains the special economic problems of Latin America, then the countries of Latin America can greatly improve their performance by adopting more open and liberal policies. If elites in Latin America come to be persuaded of this, public policies will be changed, in spite of the power of organized interests.

WHY HAS THE ECONOMIC PERFORMANCE OF SPANISH-SPEAKING AND ENGLISH-SPEAKING COUNTRIES BEEN SO DIFFERENT?

Mancur Olson

In order to make my argument about why economic performance in the Spanish-speaking countries has been different from that of the English-speaking countries, I need to set out some general ideas. These general ideas are the source for my thinking on this subject. It will take quite some time to set forth the general ideas that I will use, but once these general ideas are clear, the question posed in my title can be answered very quickly. The general ideas will, I hope, also be of interest in themselves. In any case, I ask the reader to be patient and to take my word for it that I will indeed offer an answer to the question posed in my title.

The first of the general ideas that I need to develop is concerned with the role of organized interests in society. Most of the paper will be devoted to the development of this general idea. Once the role of vested interests is understood, especially where international trade is concerned, we will be in a position to see the main way in which ideas can also affect society.

The second general idea that will be set forth has to do with the influence of ideas on societies. In the course of the discussion of this matter, we will come upon an answer to the question of why economic performance has been so different in the Spanish-speaking and English-speaking countries.

Now, in the first and main part of this paper, I shall attempt to show why organized interests have such a large impact on economic performance, especially when they influence policy with respect to international trade and foreign investment.

PART ONE

The argument here takes for granted the conclusions of my book on The Logic of Collective Action.[1] That book argued that not only governments, but also many nongovernmental or private associations produce public or collective goods. The benefits of lobbying organizations that win favorable legislation or regulations for those in some industry, occupation, or other group usually go automatically to everyone in the relevant category; the higher price or wage obtained by any cartelistic organization similarly goes to every seller. Such benefits are then public goods in the sense that they go to everyone in some group if they go to anyone in the group, even though the special-interest legislation or cartel price may of course be harmful to society as a whole. It follows from this that, at least if a group is large, it will not act to serve its common interests, which are collective goods to it, by voluntary or market action. If a typical individual in a group of, say, a million makes a

[1]The Logic of Collective Action (Cambridge, Mass.: Harvard University Press, 1965).

contribution to the provision of a collective good for his group, he bears the whole cost of that contribution but gets on average one millionth of the benefit. The typical individual's voluntary participation in or contribution to any organization seeking to serve his group's interest will accordingly be strikingly less than what would be required for "group optimality" (Pareto-optimality for the group), if indeed there is any participation or contribution at all.

It follows that large groups that succeed in organizing to serve their collective interests must use "selective incentives," or individual punishments or rewards that distinguish between those members of the group that do contribute to the collective effort from those who do not. The coercive poser of a "union shop" with a dues check-off and a picket line that is dangerous to cross on this interpretation is analogous to compulsory taxation by governments that provide collective goods to an entire society. The coercion in both cases provides a selective incentive because only those who do not pay dues or taxes are punished. In subtle ways that are usually not widely understood, a great many associations use various legal advantages and complementarities between the collective action and the provision of assorted private goods to reward the individuals who contribute to the collective action, i.e., use positive selective incentives. The Logic of Collective Action claims to show that, for the United States in the mid nineteen-sixties at least, all large associations with either political or cartelistic power owed their membership to selective incentives rather than to the value of the collective good they provided for their members.

Naturally, selective incentives are hard to come by -- coercion is difficult to organize and is resisted, and it is often even more difficult to obtain the considerable resources needed to supply the positive selective incentives needed to get a large group organized. For most large groups with common interests, such as consumers, taxpayers, the poor, and the unemployed, no selective incentives are available. These groups are, for example, too scattered to be subject to picket lines. In no society are most of the people in these categories organized. Even for those groups for which selective incentives are in principle obtainable, it requires fortunate circumstances and rare qualities of political entrepreneurship to create a large scale organization. Collective action, then, is difficult and problematical for those groups for which it is possible, and for some large groups with important common interests it is impossible.

"Small" groups, by contrast, can organize with less difficulty and often without selective incentives. If two identical individuals share a common interest or collective good, each will get half of the benefit of any action in their common interest and so, even with Cournot-type behavior, will have an incentive to make substantial contributions to the common interest. Since the action of each noticeably affects the well-being of the other, they also have an incentive to bargain with one another until they have maximized their joint gains. As groups get larger the share of the total benefit that an individual obtains from any effort he makes to obtain a collective good for his group inevitably gets smaller. In other words, the "externality" to the group of individual action to provide some amount of a collective good for the group rises with the number of members in the group, so the extent to which the individuals in the group have an incentive to act in the group interest diminishes as the group gets larger, the large groups fall farther short of providing themselves with group-optimal amounts of collective goods. This point is argued in a less casual way in The Logic, and it is crucial to the argument in the present paper.

II

If the logic that has been impressionistically described is correct, and if we combine it in certain cases with conventional propositions from microeconomic theory and a few other assumptions that will probably not be controversial, a number of further implications follow. The connections to these further implications are set out with some care in my book on The Rise and Decline of Nations[2], but some may prefer a briefer and more casual discussion, so this paper will attempt to make each of the implications intuitively plausible in a few sentences.

Implication I is that no society can attain symmetrical or complete organization of group interests, so that it is and will be impossible for leaders of all groups to bargain together to obtain a "core" or Pareto-efficient allocation of resources. This follows trivially from the fact that some large groups do not have access to selective incentives. Implication II is that stable societies with unchanged boundaries will accumulate more organizations and collusions for collective action over time. The reason for this is that as time goes on more of those groups that can organize will have enjoyed the fortunate circumstances and able political entrepreneurship that is needed for organization, whereas the interest of organizational leaders in maintaining their position insures that organizations with selective incentives will not disappear unless destroyed by upheaval or war. Implication III is that "small" groups have disproportionate organizational power in all societies, but since they are not as slow to organize as large groups this disproportion is greater in societies that have lately suffered instability. This follows directly from the logic referred to above.

The fourth implication arises from the fact that, if the associations or collusions for collective action are small in relation to the society of which they are a part, they will gain little from trying to make their societies more efficient, because their members get only a minute fraction of the gains from a more efficient society (they are in a position akin to that of an individual in a large group). Similarly, they will gain from obtaining a larger share of the social output for their members, even if the social loss from the redistribution is a substantial multiple of the amount distributed to them. Thus, with some exceptions, associations for collective action are coalitions which engage in distributional struggle rather than in efforts to increase social efficiency. There are compelling reasons set out elsewhere for believing that most of the efforts of distributional coalitions have excess burdens that are large in relation to the amount they win in distributional struggle. Implication IV is therefore that special-interest organizations and collusions are largely distributional coalitions which on balance reduce the efficiency and income of the societies in which they are located.

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[2] New Haven, Yale University Press, 1982.

Implication V is that associations that encompass a large part of the societies in which they are located are severely constrained in seeking redistributions toward their own clients because their own members will bear much of the social costs; if an association represents half of the income-earning capacity of the country, its members will on average suffer half of the loss in social efficiency that results from the redistribution, and it will accordingly not seek any redistributions to its members which cost the society more than twice as much as the amount distributed to its members.

Implication VI is that distributional coalitions will make decisions more slowly than the individuals and firms of which they are comprised (because they must make decisions either through by-laws or by unanimous consent bargaining), and will accordingly tend to have crowded agendas and bargaining tables. Implication VII is that distributional coalitions slow down a society's capacity to adopt new technologies and to reallocate resources in response to changing conditions, and thereby reduce the rate of economic growth. Partly this is due to the crowded agenda and slow decision-making and partly to considerations that are not intuitively obvious or susceptible to summary description. Implication VIII is that distributional coalitions are exclusive; if they are cartels there are fewer sales at the cartel price for each member if new members enter, and if they seek redistributions politically the members will gain from having a minimum winning coalition. Finally, Implication IX is that the accumulation of distributional coalitions increases the complexity of regulation and the role of government, partly for reasons that are not immediately obvious nor capable of brief description.

The Rise and Decline of Nations argued that the preceding considerations help to explain the rapid growth of Japan and West Germany after World War II. The totalitarian governments that had controlled these countries had destroyed most of the organizations for collective action, and certainly all of those on the left, and the occupying powers subsequently eliminated any that collaborated. As a result these countries have had relatively few distributional coalitions, and those they do have are, sometimes because of promotion by occupation authorities, usually relatively encompassing. By the same token, if the argument adumbrated above is correct, the slow economic growth of Great Britain is partly explained by the fact that its uniquely long record of stability and immunity from invasion have given it more time to accumulate special-interest organization and collusion than other countries. Similarly, the relatively rapid growth of the West and South of the United States and the relatively slow growth of the Northeast and older Middle West are also consistent with the argument. The West because of recent settlement and the South because of the Civil War and its aftermath have had relatively little time to accumulate distributional coalitions, whereas the Northeast and the older Middle West have had a considerable time to accumulate such coalitions.

The countries and regions that have just been mentioned constitute important anomalies, but the theory is called into question if it cannot explain other cases as well. The world is complex and multi-casual, so no theory should be expected to explain everything, but a theory's claim to credence still rises if the range of its explanatory power can be increased without complicating it or introducing new variables. Thus the pages that follow endeavor to explain the growth of a number of other countries and historical periods.

III

As we can see from Table 1, the original six members of the European Economic community have grown relatively rapidly since World War II, particularly in comparison with Australia, New Zealand, the United Kingdom, and the United States. For some of the member countries the growth was fastest in the nineteen sixties when the Common Market was going into effect. Though I have offered some explanation of the most anomalous or puzzling case of rapid growth in Germany there has been no analysis of the rapid growth of the other four members of the Six. As it turns out, the analysis of the Common Market will also show why New Zealand's postwar growth performance has been as bad as that of the United Kingdom, and why Australia, despite its good fortune in discovering rich deposits of natural resources, has nonetheless grown relatively slowly.

Looking at the timing of the growth of most of the Six, it is tempting to conclude, as many casual observers have, that the Common Market was responsible. This is post hoc ergo propter hoc reasoning and we obviously cannot rely on it, especially in view of the fact that most if not all of the careful quantitative studies indicate that the gains from the Common Market were very small in relation to the increases in income that the members enjoyed. The quantitative studies of the gains from freer trade, like those of the losses from monopoly, usually show far smaller effects than economists anticipated, and the calculations of the gains from the Common Market fit the normal pattern. The studies of Edwin Truman and Mordechai Kreinin, for example, while arguing that trade creation overwhelmed any trade diversion, imply that the Common Market added two percent or less to EEC manufacturing consumption.[3] Bela Balassa, moreover, argues that, taking economies of scale as well as other sources of gain from the Common Market into account, there was a "0.3 percentage point rise in the ratio of the annual increment of trade to that of GNP" which was probably "accompanied by a one-tenth of one percentage point increase in the growth rate. By 1965 the cumulative effect of the Common Market's establishment on the Gross National Product of the member countries would thus have reached one-half of one

[3]Edwin M. Truman, "The European Economic Community: Trade Creation and Trade Diversion," Yale Economic Essays 9 a9spring 1969), 201-251; Mordechai Kreinin, Trade Relations of the EEC: An Empirical Investigation (New York: Praeger, 1974), Ch. 3, 25-55. See also John Williamson and Anthony Battrill, "The Impact of Customs Unions on Trade in Manufacturers," in The Economics of Integration, ed. by Melvyn G. Krause (London: George Allen & Unwin, 1973).

percent of GNP."[4] Careful studies by other skilled economists also suggest that the intuitive judgment that large customs unions can bring about really substantial increases in the rate of growth is not supported by economists' typical comparative-static calculations.

Table 1

Table 1 Average Annual Rates of Growth of Per Capita Gross Domestic Product at Constant Prices (in percent)

Country	*1950–1960*	*1960–1970*	*1970–1978*
Australia	2.0[a]	3.7[b]	2.4[c]
Austria	5.7	3.9	3.8
Belgium	2.0[d]	4.1	3.1
Canada	1.2	3.7	3.1
Denmark	2.5	3.9	2.2
Finland	3.3	4.2	2.5
France	3.5	4.6	3.0
Germany, Fed. Rep. of	6.6	3.5	2.4
Ireland	1.8	3.8	2.3[e]
Italy	4.9[f]	4.6	2.1[g]
Japan	6.8[h]	9.4	3.8
Netherlands	3.3	4.1	2.3
New Zealand	1.7[i]	2.2[j]	—[k]
Norway	2.7	4.0	3.9
Sweden	2.9	3.6	1.2
Switzerland	2.9	2.8	−0.1
United Kingdom	2.3	2.3	2.0
United States	1.2	3.0	2.0

NOTE: Data are from *Yearbook(s) of National Account Statistics* for 1969 and 1978, Statistical Office of the United Nations, New York, published in 1970 and 1979, respectively.

a. 1952–1960; b. 1963–1970; c. 1970–1976; d. 1953–1960; e. 1970–1977; f. 1951–1960; g. 1970–1977; h. 1952–1960; i. 1954–1960; j. 1960–1968; k. The statistics for New Zealand in this period are not separated from those for "Oceania."

IV

There is a hint that there is more to the matter in some of the more remarkable instances of economic growth in historical times. The United States became the world's leading economy in the century or so after the adoption of its constitution. Germany similarly advanced from its status as a poor area in the first half of the nineteenth century to the point where it was by the start of World War I overtaking Britain, and this occurred after

[4]Bela Balassa, "Trade Creation and Trade Diversion in the European Common Market," Economic Journal 77 (March 1967), 1-21.

the Zollverein or customs union of most German-speaking areas and the political unification of Germany. These two situations, I shall argue, were similar to the Common Market in three crucial ways. The similarities are sometimes overlooked because the conventional nomenclature calls attention to the differences between the formation of governments and of customs unions.

One of the crucial features of the Common Market was, of course, that it created a large area within which there was something approaching free trade. A second was that it allowed relatively unrestricted movement of labor, capital, and firms within this larger area. A third was that it shifted the authority for decisions about tariffs and certain other matters from the capitals of each of the Six nations to the European Economic Community as a whole. When we think about these features, we immediately realize that the creation of a new or larger country out of many smaller jurisdictions also includes each of these three fundamental features.

As has often been pointed out before, the establishment of the United States of America out of the thirteen independent ex-colonies also involved the creation of an area of free trade and factor mobility, as well as a shift in the institutions which made certain decisions. The adoption of the Constitution did in fact negate tariffs that New York had established against certain imports from Connecticut and New Jersey. Similarly, not only the Zollverein, but also the creation of the German Reich itself included the same essential features. Most of the German-speaking area of Europe until well into the nineteenth century were separate principalities or city-states or other small jurisdictions with their own tariffs, barriers to mobility, and economic policies, but an expanding common market, as well as a shift of many governmental powers, resulted from the Zollverein and even more from the formation of the German state that was complete by 1871.

There was also a much earlier development elsewhere in Europe that created vastly larger markets, established far wider domains for factor mobility, and shifted the locus of governmental decision-making. The centralizing monarchs of England and France in the late fifteenth and sixteenth centuries tried to create nation-states out of the existing mosaic of parochial feudal fiefdoms; there had been nominal national kingdoms before, but as the textbooks tell us, the real power normally rested with lords of various fiefs or sometimes with virtually self-governing walled towns. Each of these mini-governments tended to have its own tolls and tariffs; a boat trip along the Rhine, with its toll-collecting castles sometimes only about a kilometer apart, is sufficient to remind one how numerous local tolls in Medieval Europe were. The nationalizing monarchs with their mercantilistic policies usually strove to eliminate these local authorities and their restrictions, and in turn imposed highly protectionist policies at the national level. In France a significant proportion of the feudal tolls and restrictions to trade and factor mobility were not removed until the French Revolution, but in Britain the creation of nationwide markets took place more rapidly. Interestingly, creation of effective national jurisdictions in Western Europe was followed by the commercial revolution and in Britain ultimately by the industrial revolution, and in a more general sense by the "rise of the West."

In many respects, and possibly the most important ones, the creation of meaningful national governments is very different from the creation of customs unions, however effective the customs union might be. Nonetheless, in all of the cases we have considered, a much wider area of relatively free trade was established, a similarly wide area of relatively free movement of factors of production was created, and the power to make at least some important decisions about economic policy was shifted to a new institution in a new location. There was in each case at least a considerable measure of what I shall here call "jurisdictional integration." It would be much better if we could avoid coining a new phrase, especially such a ponderous one, but the familiar labels obscure the common features that concern us here.

Since there are several cases of jurisdictional integration followed by relatively rapid economic progress, it is now even more tempting than it was when we looked at the Common Market alone to posit a causal connection. But that would still be premature. For one thing, we should have some idea just how jurisdictional integration would bring about rapid growth, and statistical studies such as those cited above for the Common Market suggest that the gains from the freer trade are not nearly large enough to explain substantial economic growth. For another, the number of cases of jurisdictional integration is still not large enough to allow confident generalization. We must therefore look at the specific patterns of growth within jurisdictions as well as across them to see if they provide corroborating evidence, and in addition present a theoretical model that could explain why jurisdictional integration should have the observed effects.

V

One of the most remarkable and consistent patterns in the advancing economies of the West in the early modern period was the relative (and often absolute) decline of most of what had been the major cities. This decline of many of the major cities is paradoxical, for the single most important development moving the West ahead was surely the industrial revolution and Western society today is probably more urbanized than any society in history. The commercial and industrial revolutions created new cities, or made great cities out of mere villages, rather than building upon the base of the existing larger medieval and early modern cities. Major capitals like London and Paris grew, of course, as administrative centers and as consumers of part of the new wealth, but they were by no means the sources of the growth. As the famous French historian Fernand Braudel puts it, "The towns were an example of deep-seated disequilibrium, asymmetrical growth, and irrational and unproductive investment on a nationwide scale.... These enormous urban formations are more linked to the past, to accomplished evolutions, faults and weaknesses of the societies and economies of the Ancien Regime, than to preparations for the future.... The obvious fact was that the capital cities would be present at the forthcoming industrial revolution in the role of spectators. Not London, but Manchester, Leeds, Glasgow, and innumerable small proletarian towns launched the new era."[5]

M.J. Daunton shows that, at least for Great Britain during the Industrial Revolution, Braudel was right. Of the six cities that are deemed to be the largest in England in 1600, only Bristol and of course London, were among the top six in 1801. Manchester, Liverpool, Birmingham, and Leeds completed the list in 1801. York, the 3rd largest city in 1600, was the 17th largest in 1801; Newcastle, the 5th largest city in 1600, was the 14th largest in 1801, as will be seen from Table 2.[6]

Table 2

English Cities Ranked by Size

1600		*1801*	
Rank	*Population*	*Rank*	*Population*
1. London	250,000	1. London	960,000
2. Norwich	15,000	2. Manchester	84,000
3. York	12,000	3. Liverpool	78,000
4. Bristol	12,000	4. Birmingham	74,000
5. Newcastle	10,000	5. Bristol	64,000
6. Exeter	9,000	6. Leeds	53,000
		8. Norwich	37,000
		14. Newcastle	28,000
		17. York	16,000

Even in the years before 1601 there was a concern among contemporaries about the "desolation of cytes and tounes." Charles Pythian-Adams' essay on "Urban Decay in Late Medieval England" argues from a mass of detailed if scattered figures and contemporary comments that the population and income of many English cities had begun to decline before

[5]Fernand Braudel, Capitalism and Material Life, translated by Miriam Kohan (New York: Harper and Row; London: George Weidenfeld and Nicholson, 1973), 439-40. Published in France as Civilisation Materiel et Capitalism.

[6] M.J. Daunton, "Towns and Economic Growth in Eighteenth-Century England," in Towns and Societies, Phillip Abrams and F.A. Wrigley, eds., 247.

the Black Death. Though Pythian-Adams finds that the decline of certain cities may be offset by the expansion of others, we are left wondering why so many towns decline while others grow. During the late 15th and early 16th centuries, and especially between 1520 and 1570, Pythian-Adams finds most of the more important towns were "under pressure," if not in an "acute urban crisis" often involving significant loss of economic activity and population.[7]

On the Continent towns were not so often partially autonomous institutions operating within relatively stable national boundaries. Partly because of this, and partly because the Continent did not experience the rapid changes of the Industrial Revolution until later, the situation there is not so easily summarized. Nonetheless, there were many similar replacements of older urban centers with newer towns or rural industry. One example is the shift of some of the medieval woolen industry from the cities of Flanders to nearby Brabant and the decline of Flemish woolen production generally in relation to that of the North Italian cities, which in their turn declined as well. Another is the decline of Naples, which on the eve of the French Revolution was probably Europe's fourth largest city. One classic case is the decline of the central city of Aachen, and the shift of industry to the suburbs, which Herbert Kisch has chronicled in detail.[8] The expansion of the suburbs at the expense of the old city was a commonplace.[9]

VI

Medieval towns and cities were normally small by modern standards. Their boundaries were usually precisely defined by city walls and they often had a substantial degree of autonomy (and in some cases were independent of any larger government). Within these small jurisdictions there would naturally be only a few merchants in any one line of commerce and only a limited number of skilled craftsmen in any one specialized craft, even if the population of the town was in the thousands. The primitive methods of transportation in medieval times and the absence of safe and passable national road systems also tended to segment markets, so that a handful of merchants or skilled craftsmen could more easily secure a monopoly if they could cartelize local production. When the merchants in a given line of commerce had more wealth than the townspeople generally, it seemed likely that they would

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[7]Charles Pythian-Adams, "Urban Decay in Late Medieval England" in Towns and Societies, op. cit. 159-185.

[8] Herbert Kisch, "Growth Deterrents of a Medieval Heritage: The Aachen Area Woolen Trades Before 1790," Journal of Economic History, Vol. 24 (Dec. 1964), pp. 517-537. On these matters see also Dudley Dillard, Economic Development of the North Atlantic Community (Englewwod Cliffs, New Jersey: Prentice Hall, 1967) and Henri Pirenne, Economic and Social History of Medieval Europe (London: Routledge and Kegan Paul, 1936).

[9] Braudel, op. cit., 404-405.

interact with one another more often than with those of slender means. To some extent, this would often happen also among those who shared the same skilled craft.

The logic of collective action implies that small groups have far greater opportunities to organize for collective action than large ones, and suggests that if other things are equal there will be relatively more organization in small jurisdictions than in large ones. The logic also implies that small and homogeneous groups that interact socially also have the further advantage that social selective incentives will help them organize for collective action. These considerations entailed Implication Three, that small groups were better and sooner organized than large ones. If the logic referred to earlier was correct, it follows that the merchants in a given line of commerce and practitioners of particular skilled crafts in a medieval city would be especially well placed to organize collective action. If the city contained even a few thousands of people, it is not likely that the population as a whole could organize to counter such combinations, though in tiny villages the population would be small enough for this to occur.

VII

The result of these relatively favorable conditions for collective cartelistic action was of course the guilds. The guilds naturally endeavored to augment the advantages of their small numbers and social homogeneity with the coercive civic power as well, and many of them did indeed influence if not control the towns in which they operated. This outcome was particularly likely in England, where the national monarchies found it expedient to grant towns a substantial degree of autonomy. In what is now Germany guilds would more often confront small principalities more jealous of their power and would need to work out symbiotic relationships with territorial rulers and the nobility. Often in France, for example, the guild would be one of the few ways in which the government could successfully collect taxes, given its administrative limitations, so guilds would sometimes be given monopoly privileges in return for tax payments. The city-states of North Italy extended well beyond the walls of the town, and in these cases the guilds would have a wider sphere of control if they shared power, but at the same time were thereby exposed to instabilities in the North Italian environment which must often have interrupted their development or curtailed their powers. In spite of all the variation from region to region, it is notable that guilds of merchants and master craftsmen, and occasionally also guilds of journeymen, became commonplace from Byzantium in the East to Britain in the West, and from at least the Hanseatic cities in the North to Italy in the South.

The guilds both strengthened themselves and served a useful function in providing social insurance for those of their numbers who fell upon misfortune. They possibly also provided some degree of quality control, much as modern professional associations do, though it is doubtful that the levels of quality they stipulated were optimal for their customers.

Overwhelmingly the guilds were nonetheless distributive coalitions which used monopoly power and sometimes also political power to serve their interests. And, as

Implications IV and VII predict, they reduced economic efficiency and delayed technological innovation. The fact that apprenticeship was used to control entry is demonstrated conclusively by the requirement in some guilds that a journeyman could become a master only upon the payment of a fee, by the rule in some guilds that apprentices and journeymen could not marry, and by the stipulation in other guilds that the son of a master need not serve the apprenticeship that was normally required. The myriad rules that were intended to keep one master from advancing significantly at the expense of his fellows surely limited innovation.

VIII

What should be expected when there is jurisdictional integration in an environment of relatively autonomous cities with a dense network of guilds? Implication II indicated that the accumulation of special-interest organizations occurs gradually in stable societies with unchanged borders. If the area over which trade can occur without tolls or restrictions is made vastly larger, a guild or any similar cartel will find that it monopolizes only a small part of the total market. A monopoly of a small part of an integrated market is, of course, not a monopoly at all: no one will pay a monopoly price to a guild member if they can buy at a lower price from those outside the guild. With jurisdictional integration there is also free movement of the factors of production within the integrated jurisdiction, so there may also be an incentive for sellers to move into any community in the jurisdiction in which cartelization has brought higher prices. Jurisdictional integration also means that the political decisions are now made by different people in a different institutional setting at a location that is probably now quite some distance away. The amount of political influence that is required to change the policy of the integrated jurisdiction will also be vastly larger than the amount that was needed in the relatively parochial jurisdiction that previously prevailed. Thus guilds usually lost both their monopoly power and their political influence when integrated nation-wide jurisdictions replaced local jurisdictions.

The level of transportation costs is also significant. If transportation costs are too high to make it worthwhile to transport a given product from one town to another, the jurisdictional integration should be less significant, though there would still be a tendency for competing sellers to migrate to the cartelized locations in the integrated jurisdiction. The time of the commercial revolution was also a time of improved transportation, especially over water, which led to the development of new routes to Asia and the discovery of the New World. The growth in the power of central government also reduced the danger of travel from community to community by gradually eliminating the anarchic conflict among feudal lords and the extent of lawlessness in rural areas, and even lead to more road building and (later) to the construction of canals. If the countryside is relatively safe from violence, transportation is not only cheaper but production may also take place wherever costs are lowest.

When jurisdictional integration occurs, new distributive coalitions matching the scale of the larger jurisdiction will not immediately spring up because, as we know from

Implication II, such coalitions emerge only gradually in stable situations. It will not, however, take small groups as long to organize as large ones (Implication III). Thus the great merchants involved in larger scale trade, often over greater distances, were among the first groups to organize or collude on a national scale. They were often also extremely successful - as Adam Smith pointed out, the influence of the "merchants" gave the great governments of Europe the policy of "mercantilism," which favored influential merchants and their allies at the expense of the rest of the nation. Often this involved severely protectionist policies which protected the influential merchants form foreign competitors -- mercantilism is to this day used practicially as a synonym for protectionism.

It might seem, then, that the gains from jurisdictional integration in early modern Europe were brief and unimportant, since the mercantilist policies followed close on the heels of the decaying guilds in the towns. Not so. The reason is that tariffs and restrictions around a sizeable nation are less serious than tariffs and restrictions around each town or fiefdom. Much of the trade will be intranational whether the nation has tariffs at its borders or not, because of transport costs and the natural diversity of any large country. Trade restrictions at national borders do not have any direct effect on this trade, whereas trade restrictions around each town and fiefdom do reduce or eliminate most of it. Moreover, as Adam Smith pointed out, "the division of labor is limited by the extent of the market," and thus the widening markets of the period of jurisdictional integration also made it possible to take advantage of economies of scale and specialization. Another way of thinking of the matter involves noting that the shift of trade restrictions from a community level to a national level reduces the number of miles of tariff barriers by a vast multiple. I believe that the greatest reductions of trade restrictions in history have come from reducing the mileage rather than the height of trade restrictions.

IX

Since the commercial and the industrial revolutions took place during and after the extraordinary reduction in trade barriers and in other guild restrictions, and occurred overwhelmingly in new cities and suburbs relatively free of guilds, there appears to have been a causal connection. Yet both the timing of growth and the fact that guilds were regularly at the locations where the growth was obstructed could conceivably have been coincidences. Happily, there are additional aspects of the pattern of growth which suggest that this was not the case.

One of these is the "putting out system" in the textile industry, which was then the most important "manufacturing" industry. Under this remarkable system, merchants would travel all over the countryside to "put out" to individual families material that was to be spun or woven, and then return at a later time to pick up the yarn or cloth. Clearly such a system required a lot of time, travel, and transactions costs. There was the question of exactly how much material had been left with each family and of how much yarn or cloth could be made from it, so that there were innumerable occasions for haggling and disputes. The merchant also had the risk that the material he had put out would be stolen. Given the obvious disadvantages, we must ask why this strange system was used. The answer from any number of accounts is that this system despite its disadvantages was cheaper than production in towns controlled by guilds. There may have been some advantages of production scattered throughout the countryside, such as cheaper food for the workers, but this could not explain the tendency at the same time for production to expand in suburbs around the towns controlled by guilds. (Adam Smith said that "if you would have your work tolerably executed, it must be done in the suburbs, where the workmen have no exclusive privilege, having nothing but their character to depend upon, and you must then smuggle it into town as well as you can."[10] Neither can any possible inherent advantages of manufacturing in scattered rural sites explain the objections of guilds to the production in the countryside; Flemish guilds, for example, even sent expeditions into the countryside to destroy the equipment of those to whom materials had been put out.

There was also a tendency for economic growth to occur in parts of Europe in which jurisdictional integrations and political upheaval had undermined distributional coalitions of various kinds. A centralized national government came relatively early to England, perhaps in part because it was an island nation. The commercial revolution by all accounts was also relatively strong in that country. In the seventeenth century, and even to an extent in the very early eighteenth century, Britain suffered from civil war and political instability (see, for example, Christopher Hill[11] and J.H. Plumb[12]). Undoubtedly the instability brought some destruction and waste and in addition discouraged long run investment. But within a few decades after it became clear that stable and nationwide government had been re-established in Britain the Industrial Revolution was underway. It is also generally accepted that there was much less restriction of enterprise and trade in mid-eighteenth century Britain than in most of the Continent.

Similarly, the remarkable growth in Holland took place just after that country (or part of it) won independence from Spain. There was also economic progress in France, though less than in England and Holland. There was considerable integration of a relatively large jurisdiction in early modern France, but no upheaval sufficient to destroy many distributional coalitions involving the nobility and the guilds until the French revolution. French kings short of money for wars and other dissipations also often gave legal status to various cartels in return for special taxes. The German-speaking and Italian-speaking parts of Europe did not experience jurisdictional integration until the second half of the nineteenth century and they did not enjoy their share of Europe's advancing prosperity until then either. Of course, thousands of other factors were also important in explaining the varying fortunes of the

[10]Adam Smith, An Inquiry Into the Nature and Causes of the Wealth of Nations, Book I, Chapter X, Part Two, Eds. R.H. Campbell, A.S. Skinner, and W.B. Todd (Oxford: Clarendon Press, 1976), p. 146.

[11]New York: W. W. Norton, 1962.

[12]Boston: Houghton Mufflin, 1967.

different parts of Europe, and it would be preposterous to offer the present argument as a monocausal explanation. In view of the importance of the other factors involved, it is nonetheless remarkable how well the theory fits the pattern and timing of growth in Europe.

In the case of the United States, there was not only the Constitutional provision mentioned earlier that prohibited separate states from imposing barriers to trade and factor mobility, but also over a century of westward expansion. Any cartel or lobby in the United States before the present century had to face the fact that substantial new areas were regularly being added to the country. Competition could always come from these new areas, notwithstanding the high tariffs at the national level, and the new areas also increased the size of the polity, so that ever larger coalitions would be needed either for cartelization or lobbying. Vast immigration also worked against cartelization of the labor market. In addition, the United States, like all frontier areas, could begin without a legacy of distributional coalitions and rigid social classes. In view of all this, the extraordinary achievement of the U.S. economy for a century and more after the adoption of the Constitution is not surprising.

X

The case with which we began, the rapid growth in the sixties of the Six nations that created the Common Market, also fits the pattern. The three largest of these countries, France, Germany, and Italy, had suffered a great deal of instability and invasion. This implied that they had relatively less special-interest organization than they would otherwise have had, and often also more encompassing organizations. In France and Italy the labor unions did not have the resources or strength for sustained industrial action; in Germany the union structure growing out of the occupation was highly encompassing.

As Implication III tells us, small groups can organize more quickly and thoroughly than large groups, so even in the countries that had suffered the most turbulence those industries that had small numbers of large firms were likely to be organized. In Italy the Allied occupation had not been so thorough and some industries remained organized from Fascist times. In all of the countries, organizations of substantial firms, which were often manufacturing firms, would frequently have an incentive to seek protection through tariffs, quotas, or other controls for their industry, and in at least some of these countries they were very likely to get it. Once imports could be excluded the home market could also be profitably cartelized. If foreign firms should seek to enter the country to compete with the domestic firms the latter could play upon nationalistic sentiments to obtain exclusionary or discriminatory legislation against the multinationals. At times in some countries, such as in postwar Germany at the time of Erhard, there would because of economic ideology or the interests of exporters be some determined resistance to protectionist pressures, but in other countries like France and Italy in the years just before the creation of the Common Market the capacity or the inclination to resist these pressures was lacking.

In France and Italy and to some extent in most of the other countries, the coalitional structure and government policy insured that tariffs, quotas, exchange controls, and restrictions on foreign firms were possibly the principal threat to economic efficiency. In France, for example, as Jean-Francois Hennart argues in "The Political Economy of Comparative Growth Rates: The Case of France,"[13] exchange controls, quotas, and licenses had nearly closed off the French market from foreign competition; raw materials were often allocated by trade associations, and trade and professional associations fixed prices and allocated production in many important sectors. In such situations the losses from protectionism and the cartelization it facilitates could hardly be small. If a Common Market could put the power to determine the level of protection and to set the rules about factor mobility and entry of foreign firms into the market out of the reach of each nation's colluding firms, the economies in question could be relatively efficient. The smaller nations among the Six were different in several respects, but they would also gain greatly from freer trade, in part because their small size made protectionist policies more costly for them. Most of the founding members of the European Community, then, were countries with coalitional structures, protectionist policies, or small sizes that made the Common Market especially useful to them. This would not have so clearly been the case if the Common Market had chosen very high tariff levels against the outside world, but the important Kennedy Round of tariff cuts insured that that didn't happen.

It doesn't follow that every country that joins any institution called a common market will enjoy gains comparable to those obtained by most of the Six. Whether a nation gains from a customs union depends on many factors, including its prior levels of protection and (to a lesser extent) those of the customs union it joins. In the case of France and Italy, for example, the Common Market almost certainly meant more liberal policies for trade and factor mobility than these countries would otherwise have had. In the case of Great Britain, where the interests of organized exporters and the international financial community in the City of London have long been significant, the level of protection was not so high, and it isn't obvious that joining the Common Market on balance liberalized British trade. When many high-tariff jurisdictions merge there is normally a great reduction in tariff barriers, even if the integrated jurisdiction has equally high tariffs, but a country with low tariffs already is getting most of the attainable gains from trade. The coalitional structure of a society also makes a difference. In Britain the professions, government employees, and many firms (such as "High Street" or downtown retail merchants) that would have no foreign competition in any case, are well organized; joining the Common Market could not significantly undermine their organizations. More foreign competition for manufacturing firms can reduce the power of unions, since manufacturers whose labor costs are far out of line must either cut back production or hold out for lower labor costs, but even here the influence is indirect and presumably not as significant as when imports directly undermine a cartel of manufacturing firms. Common Markets have been even tried or proposed for developing countries with comparative advantage in the same goods and thus little reason to trade with one another, but

[13]In Dennis Mueller, ed., The Political Economy of Growth (New Haven: Yale University Press, 1983).

this cannot promote growth. For these and other reasons, it isn't possible to say whether a customs union will be good or bad fr a country's growth. One has to look at the prior level of protectionism, the coalitional structure, the potential gains from trade among the members, and still other factors in each individual case.

XI

The postwar growth rates of Australia and New Zealand, we recall, are not impressive. They have had rather long histories of stability and immunity from invasion, but not nearly as long a period of stability as Britain. Though they enjoy exceptional endowments of natural resources in relation to population, their levels of per capita income have lately fallen behind those of many crowded and resource-poor countries in Western Europe. Some calculations of average tariff levels for these two countries, in combination with the foregoing analysis of jurisdictional integration, immediately suggest an explanation for their poor growth performance. Table 3 presents alternative calculations of average industrial tariff levels for a number of countries that were prepared by the Office of the President's Special Representative for Foreign Trade. The two columns at the extreme right of the table probably offer the best measures (because in those columns the weight or relative importance attributed to each tariff on each commodity is given by the average imports of that commodity by all of the countries considered), but the other measures and calculations by other bodies produce broadly similar results. Nontariff barriers may often be more important than tariffs, but they are both generated by the same organizational and political forces and almost certainly vary across countries in somewhat the same way. The table shows that Australia and New Zealand, and especially New Zealand, have far higher tariffs than any of the other countries described. Their levels of protection are two to three times the level in the EEC and the US, and four to five times as high as those of Sweden and Switzerland. As might be expected from the level of its tariffs, quotas on imports are also unusually important in New Zealand. The impact of protection levels that are uniquely high by the standards of the developed democracies is made even greater by the small size of Australian and New Zealand economies; a large integrated jurisdiction like the EEC or the United States would not lose nearly as much per capita from the same level of protection as Australia and New Zealand do.

The theory offered in this paper suggests that manufacturing firms and urban interests in Australia and New Zealand would have organized to seek protection. When this protection was attained they would sometimes have been able to engage in oligopolistic or cartelistic practices that would not have been feasible with free trade. With high tariffs and limitations on domestic competition firms could survive even if they paid more than competitive wages, so there was more scope for labor unions and greater gains from monopolizing labor than otherwise., Restrictions on Asian immigration would further facilitate cartelization of labor. Stability and immunity from invasion would insure that few special-interest organizations would be eliminated, but more would accumulate (Implication II) as time went on. The result would be that the frontier initially free of cartels and lobbies would eventually become highly organized, and economies that initially had exceptionally high per capita incomes would eventually fall behind the income levels of European countries with incomparably lower ratios of natural resources to population.

Table 3

Table 5.2. Average Industrial Tariff Levels

	No trade weighting:[a] simple average		Own country import weighting:[b]		"World" Weights[c]: Import weights on BTN aggregates[d]		"World" Weights[c]: Import weights on each BTN commodity[e]	
	1976 Ave.	Final[f] Ave.	1976 Ave.	Final Ave.	1976 Ave.	Final Ave.	1976 Ave.	Final Ave.
Australia								
Dutiables[g]	28.8	28.0	29.1	28.1	27.8	26.7	26.4	25.2
Total[h]	16.9	16.5	15.4	15.1	13.3	12.8	13.0	12.6
New Zealand								
Dutiable	31.4	28.3	28.6	25.5	33.0	30.4	30.2	27.5
Total	24.3	21.9	19.7	17.6	20.5	18.7	18.0	16.3
EEC								
Dutiable	8.8	6.0	9.8	7.2	9.5	7.0	9.6	7.1
Total	8.0	5.5	6.3	4.6	7.0	5.2	6.9	5.1
United States								
Dutiable	15.6	9.2	8.3	5.7	9.2	5.5	7.6	4.8
Total	14.8	8.8	6.2	4.3	7.1	4.1	5.6	3.5
Japan[i]								
Dutiable	8.1	6.2	6.9	4.9	8.0	5.7	7.9	5.5
Total	7.3	5.6	3.2	2.3	6.1	4.4	5.8	4.1
Canada								
Dutiable	13.7	7.8	13.1	8.9	12.0	7.3	12.9	8.3
Total	12.0	6.8	10.1	6.8	8.9	5.5	9.4	6.1
Austria								
Dutiable	14.2	9.8	18.8	14.5	15.9	12.0	17.0	13.3
Total	11.6	8.1	14.5	11.2	10.5	7.9	10.9	8.5
Finland								
Dutiable	17.0	14.6	11.6	9.2	11.2	9.0	11.5	9.1
Total	14.3	12.3	8.2	6.5	6.7	5.3	6.7	5.3
Norway								
Dutiable	11.1	8.2	10.5	8.0	10.2	7.4	10.0	7.5
Total	8.5	6.3	6.4	4.9	5.8	4.3	5.8	4.4
Sweden								
Dutiable	7.8	6.1	7.7	5.9	7.4	5.3	7.1	5.2
Total	6.2	4.9	6.3	4.8	4.6	3.3	4.5	3.3
Switzerland								
Dutiable	3.7	2.7	4.1	3.3	4.2	3.1	4.0	3.1
Total	3.7	2.7	4.0	3.2	3.3	2.4	3.2	2.4

There is a need for detailed studies of the histories of Australia and New Zealand from this theoretical perspective. The histories of these countries, like those of others, are undoubtedly complicated and no monocausal explanation will do. Any final judgment should wait for the specialized research. But preliminary investigation of Australia and New Zealand suggests that these countries fit the theory like a pair of gloves.

XII

The paradox arising from the association between freer trade (whether obtained through jurisdictional integration or by cutting tariff levels) and faster growth, and the skillful calculations suggesting that the gains from trade creation are relatively small, remains. Indeed, since we now have a wider array of cases where freer trade is association with more rapid growth, and several aspects of the pattern of growth suggest that the freer trade is connected with the growth, the paradox is heightened. If freer trade leads to more rapid growth, why doesn't it show up in the measures of the gains from the transactions that the trade liberalization allows to take place?

The reason is that there is a further advantage of freer trade that escapes the usual comparative-static measurements. It escapes these measurements because these gains are not direct gains of those who take part in the international transactions that the liberalization permitted, but other gains from increases in efficiency in the importing country, which increases are distinct from and additional to any that arise because of comparative advantage.

We know that differences in costs of production drive the case for free trade because of comparative advantage. These differences are conventionally assumed to be due to differences in endowments of natural resources among countries, to the different proportions of other productive factors such as labor and capital in different economies, or to the economies of scale that sometimes result when different economies specialize in producing different products. If there is free trade among economies and transport costs are neglected, producers in each country will not produce a product if foreigners with their different endowments of resources can produce it at lower cost. If each country produces only those goods which it can produce at costs as low or lower than those of other countries, there will be more production from the world's resources. A country that protects domestic producers from the competition of imports gives its consumers an incentive to buy from more costly domestic producers, and more resources are used up by these producers. These resources could, in general, yield more valued output for the country if they were devoted to activities in which the country had a comparative advantage and the proceeds were used to buy imports, so normally with freer trade a country could have more of all goods, or at least more of some without less of any others.

The argument offered here is different from the conventional argument for comparative advantage, though consistent and resonant with that argument. To demonstrate that there are gains from freer trade that do not rest on comparative advantage or differences in cost of production, let us look first at the case of a country that has comparative advantage in the production of a good and exports that good, but is also subject to the evolution of distributional coalitions described in Implication II. Let us suppose the exporters who produce the good in question succeed in creating an organization with the power to lobby and to cartelize. It might seem that the exporters would have no interest in getting a tariff on the commodity they export, since their comparative advantage insures that there will not be lower cost imports from abroad in any case. In fact, exporters often do not seek tariffs. To illuminate the logic of the matter, and also to cover an important if untypical class of cases, we must note that they might gain from a tariff. With a tariff they may be able to sell what they sell on the home market at a higher price by shifting more of their output to the world market (where the elasticity of demand is usually greater) because they do not affect the world price that much (in other words, the organized exporters engage in "price discrimination" and thereby get more revenue than before). Even though the country had and by assumption continues to have comparative advantage in producing the good in question, eliminating the tariff will still increase efficiency. The reason is that the tariff is necessary to the socially inefficient two-price system that the organized exporters have arranged. This example is sufficient to show gains from freer trade that do not flow from the theory of comparative advantage or differences in costs across countries, but rather from the constraints that free trade and factor mobility impose on distributive coalitions.

To get at a far more important aspect of this matter, assume that a number of countries have comparative advantage in the same types of production. Their natural resources and relative factor endowments are by stipulation exactly the same and there are by assumption no economies of scale. Suppose that these countries for any reason had high levels of protection and that they had been stable for a long time. Then, by Implication II, they would have accumulated a dense network of coalitions. These coalitions would, by Implication IV, have an incentive to try to redistribute income to their clients rather than to increase the efficiency of the society. Because of Implications VI, VII, VIII, and IX they will make their societies have slower decision-making, less mobility of resources, higher class barriers, more regulation, and slower growth.

Now suppose the tariffs between these identical countries are eliminated. Let us suppose, in order to insure that we can handle the toughest conceivable case, that even the extent of distributional coalitions was identical in each of these countries, so there is no case for trade even on grounds of what I call "institutional comparative advantage." Even on these most difficult assumptions, however, the freeing of trade can make a vast contribution. We know from The Logic of Collective Action and Implication III that it is more difficult to organize large groups than small ones. When there are no tariffs, the only effective cartels must include all the firms in all the countries in which production could take place (unless transport costs provide natural tariffs). Thus more firms or workers are needed to have an effective cartel. Differences of language and culture may also make international cartels more difficult to establish. With free trade among independent countries there is also no way the coercive power of government can be used to enforce the output restriction cartels require. There is also no way to get special-interest legislation over the whole set of countries because there is no government over them all. Individual governments may still pass inefficient legislation for particular countries, but even this will be constrained if there is free movement of population and resources as well as free trade, since capital and labor will eventually move to jurisdictions with greater efficiency and higher incomes.

Given the difficulties of international cartelization, then, there will be, at least for some time after the freeing of trade and factor mobility, an opportunity for firms in each country to make a profit by selling in other countries at the high cartelized prices prevailing there. As firms, even if they continue to follow the cartel rules in their own country, undercut foreign cartels, all cartels fall. With the elimination of cartelization the problems growing out of Implications IV, VI, VII, VIII, and IX diminish, efficiency improves, and the growth rate increases.

Economic theory, I have argued elsewhere, is more like Newton's mechanics than Darwin's biology, and there is a need to add an evolutionary and historical approach. This is also true of that part of economic theory called the theory of international trade. The traditional expositions of the theory of international trade that focus on the theory of comparative advantage are profound and valuable. The world would be a better place if they were more widely read. They also must be supplemented by a theory of change over time of the kind that is presented in The Rise and Decline of Nations. The failure of the comparative-static calculations inspired by conventional theory to capture the increases in growth associated with freer trade is evidence that this is so.

PART TWO

The argument in Part One shows that the economic performance of nations is dramatically affected by the extent of organization of special interests, and that the amount of damage that special interests do depends in large part on the extent of protectionism. The degree of protectionism, in turn, is partly determined by the size of the market.

On the whole, Latin America has been a highly protectionist part of the world. Though there have been some pacts to create common markets in Latin America, these pacts have normally not included countries that had greatly different patterns of comparative advantage. Thus Latin America has never enjoyed the large gains from jurisdictional integration that are described in Part One.

The norm for Latin America, then, has been very high levels of protectionism, and this protectionism is all the more significant because most of the Latin American countries have smaller economies than do most of the wealthier countries of Western Europe, North America, or Japan. Though developed English-speaking countries such as Australia and New Zealand have had relatively high protection by the standards of Western Europe and the English-speaking world, even they have had much less protectionism than most Latin American countries.

I conclude that, in part, the Latin American economies have performed less well than the English-speaking countries because they have chosen more protectionism and economic nationalism than the English-speaking countries.

But that raises another important question. Why has Latin America chosen more protectionism and economic nationalism than the English-speaking countries? Mainly, I think, because liberal thinking and free trade has had less influence on Latin America than on the English-speaking world.

But that difference in thinking between the Spanish-speaking and English-speaking countries also needs to be explained. Given the argument in Part One, I also need to explain how ideas could have a large impact on the policies that countries choose. Given the large role of organized interests, how do ideas have any substantial impact on the economic policy? So we need to understand why, in spite of the great influence of organized interests, ideas play such a large role in determining economic performance. To understand this, we first need to understand the "rational ignorance" of the typical citizen.

XIII

Consider a typical citizen who is deciding how much time to devote to studying the policies or leadership of his or her country. The more time the citizen devotes to this matter, the greater the likelihood that a vote will be cast in favor of rational policies and good leadership. This typical citizen will, however, get only a small share of the gain from the more effective policies and leadership: in the aggregate, the other residents of the country will get almost all the gains, so that the individual citizen does not have an incentive to devote nearly as much time to fact finding and to thinking about what would be best for the country. Each citizen would be better off if all citizens could be induced to spend more time finding out how to vote to make the country better serve their common interests.

This point is most dramatically evident in national elections. The gain to a voter from studying issues and candidates until it is clear what vote is truly in his or her interest is given by the difference in the value to the individual of the "right" election outcome, multiplied by the probability a change in the individual's vote will alter the outcome of the election. Since the probability that a typical voter will change the outcome of the election is vanishingly small, the typical citizen, whether he is a physician or a taxi driver, is usually rationally ignorant about public affairs.

Sometimes information about public affairs is so interesting or entertaining that acquiring it for these reasons alone pays; this situation appears to be the single most important source of exceptions to the generalization that typical citizens are rationally ignorant about public affairs. Similarly, individuals in a few special vocations can receive considerable rewards in private goods if they acquire exceptional knowledge of public goods. Politicians, lobbyists, journalists, and social scientists, for example, may earn more money, power, or prestige from knowledge of public affairs. Occasionally exceptional knowledge of public policy can generate exceptional profits in stock exchanges or other markets. Withal, the typical citizen will usually find that his or her income and life chances will not be improved by the zealous study of public affairs or even of any single collective good.

This fact - that the benefits of individual enlightenment about public goods are usually dispersed throughout a group or nation, rather than concentrated upon the individual who bears the costs of becoming enlightened - explains many other phenomena as well. It explains, for example, the "man bites dog" criterion of what is newsworthy. If the television newscasts were watched or newspapers were read solely to obtain the most important information about public affairs, aberrant events of little public importance would be ignored, and typical patterns of quantitative significance would be emphasized; when the news is, by contrast, for most people largely an alternative to other forms of diversion or entertainment, intriguing oddities and human-interest items are in demand. Similarly, events that unfold in a suspenseful way or sex scandals among public figures are fully covered by the media, whereas the complexities of economic policy or quantitative analyses of public problems receive only minimal attention. Public officials, often able to thrive without giving the citizens good value for their taxes, may fall over an exceptional mistake that is simple and striking enough to be newsworthy. Extravagant statements, picturesque protests, and unruly demonstrations that offend much of the public are also explicable in this way: they make diverting news and thus call attention to interests and arguments that might otherwise be ignored. Even some acts of terrorism that are described as senseless can from this perspective be explained as effective means of obtaining the riveted attention of a public to demands about which they otherwise would remain rationally ignorant.

The rational ignorance of the typical voter is an example of the general logic of collective action. For the typical citizen, no matter how well educated he or she may be, information about public affairs is normally a public good; any benefits from the better information a typical citizen acquires about public affairs will normally be shared with the whole society, so the typical citizen will get a share of the benefits that is approximately given by the fraction of the country's national income he personally earns, yet he will bear the whole cost of whatever information he obtains about public affairs. Since the logic of collective action has been set out rigorously elsewhere and casually evoked earlier in this paper, no more will be said about it here.

XIV

The rational ignorance of the typical citizen that arises out of the logic of collective action suggests that simple ideologies and political slogans will play a gargantuan role in political life. As Anthony Downs has explained, ideologies are substitutes for detailed research and sustained reflection about public affairs. If a citizen subscribes to one of the familiar ideologies, he or she will have some guidance on what to believe. If spending a lot of time doing research on public affairs is not rational for the typical citizen but a left-wing or right-wing ideology can be acquired at little or no cost, then understandably, many people would let ideology play a large role in determining what positions they take in political discussions and in how they will vote. The ideology will indicate, or at least appear to indicate, what general policy or what political party is best for people in one's own category or social class. Clearly most of the votes cast by ordinary citizens are greatly influenced by ideology (or party affiliation, which often amounts to much the same thing).

To be sure, the rational ignorance of the typical citizen is not the only reason that ideology plays a large role in modern life. This qualification is obvious the moment one notes that some people who are social scientists, journalists, or politicians, and have strong professional incentives to be especially well informed about public affairs, are also highly ideological. Apparently some people have psychological attributes or political incentives that make them highly ideological even when well informed. Although these attributes and incentives will not be examined in this paper, I shall show that they interact with the rational ignorance of the typical citizen to give the familiar ideologies and slogans an extraordinarily large role in modern society.

XV

There is no doubt that the ideas of one great nineteenth century economist, Karl Marx, have had a decisive influence on the pattern of institutions and policies in the Soviet Union and in other communist states. Here organized vested interests did not keep Marx's ideas, as developed by Lenin and Stalin, from having a decisive influence. This experience suggests one general route by which ideas triumph. There were vested interests, such as those of the Russian Tsars, nobility, army, and officialdom, that long resisted the advance of Marxism in Russia, but the superior German forces in World War I eliminated the power behind the Russian establishment (and gave Lenin a train passage through Germany to St. Petersburg as well). The vested interests of Imperial Russia were so badly devastated that they could be done in by the not-very-well-organized forces of the liberal revolution of early 1917.

It was part of Lenin's genius that he realized this and (unlike the other Bolsheviks) sensed that the modern, democratic, and popular attributes of the liberal government did not much affect the prospects of an uprising by a minute minority, but that its not-yet-organized or unconsolidated character did. To the extent that one may summarize a complex historical event in a sentence, it was the prior destruction of organized interests and the paucity of well organized or established opposition that enabled Marxist-Leninist ideas to exert an overwhelming influence on social outcomes. The general point is that, when devastation does in organized interests, any ideas the conqueror has about what is to be done can exert an overwhelming influence.

Another class of cases where ideas have surely had a decisive cases is evident from a comparison of the countries that were once colonies of Spanish settlement with those springing from British settlement. The nations of Spanish-speaking America are systematically as well as drastically different from Australia, Canada, New Zealand, and the United States. Though Latin America was once prized much above any areas of British settlement, the Latin American countries now have per capita incomes that are only a fraction of those in the countries that were initially settled by the British. The extent and durability of democratic institutions has also been markedly less in the areas of Hispanic settlement. All sides agree that the prevalent ideas about political institutions and economic policies in most of these countries have all along been greatly different from those in the countries that were initially British colonial settlements. There is also general agreement that the great difference in civic cultures across the two sets of countries can be traced in part to the differences between England and Spain at the times the initial settlers colonized the countries in question.

I hypothesize that the fact that both sets of colonists moved to frontiers without vested interests or established organizations that could withstand or significantly influence the settlers was important in explaining the influence of the ideas or prejudices of the initial settlers. To be sure, many other factors were also very important, but there were so many separate British colonies (e.g., thirteen in what became the United States) and so many countries that grew out of the old Spanish domain, and the marks of the preconceptions of those who initially migrated have been so conspicuous, that it is hard to resist the conclusion that there could not have been much organized resistance to the implementation of the beliefs of the original settlers about what institutions and policies should prevail.

The differences in popular beliefs in Britain and Spain in the centuries of colonization obviously need a separate explanation. I am not competent to compare the histories of Britain and Spain in the necessary detail and must defer to the relevant specialists. For the sake of theoretical closure, I shall nonetheless set out an uneducated and unoriginal hunch. In Spain, the unequivocal power that the accidents of history had given the Hapsburgs and the conformity of their Catholicism with that of their Spanish subjects implied that civil order was readily obtained through uniformity and hierarchical control. In Britain, by contrast, especially in the seventeenth century, there was a great deal of religious (and other) diversity in the population. The monarchy, moreover, was not always perceived as entirely in keeping with even the protestantism that was the one common denominator to most of this diversity. The English initially were not at all tolerant or liberal about these differences and there was intense disagreement and even a civil war.

Without putting a fine point on it, one might surmise that the diverse forces were not over the long run so greatly different in strength and that with the passage of time it became increasingly plausible that imposing religious uniformity or unqualified central monarchical control on the country would be, at best, very costly. Very loosely, there was a stalemate that made acceptance of some degree of pluralism, some grudging religious toleration, and some checks on royal absolutism the most practical solution for each of the powerful interests: the ideas of Locke rather than Hobbes were favored by the stalemate. Liberal or pluralist ideas were at least more nearly compatible with British than with Spanish realities. When there is no good alternative to living with diversity and pluralism, people get used to it, and ultimately perhaps a few see some gains from trade and other interaction among those with differences. There is then an inspiration or constituency for arguments of a Smithian kind as well.

So it appears that a balance of power or stalemate among the organized interests can leave an opening for new ideas. When the different organized powers or interests more or less offset one another, ideas may make a big difference, especially if they help the contending interests or powers get out of a tight spot.

Even when vested interests are not done in by force, and there is no unorganized frontier, and also no stalemate of offsetting interests, ideas can sometimes win. We turn now to an avenue by which better ideas can influence public policy even in sclerotic environments.

XVI

In most countries the collusions and cartels that operate in the market and the lobbies that operate in the polity are uniformly small in relation to the whole society. In some cases an organization will have a membership in the hundreds of thousands or even of a million or more, but all such organizations are small in relationship to the whole society. Normally, organizations for collective action represent less than one percent of the population and also of the income-earning capacity of the society. When, as in Austria, Norway, Sweden, and (to some extent) in Germany, individual organizations for collective action encompass a large part of the income-earning capacity of the society, this will at least temporarily or episodically make them mindful[14] of the deadweight losses from their actions, since their membership will bear a large part of this loss. Thus the problem of societies losing their efficiency and dynamism through collusions and organizations for collective action is mainly a problem of tiny minorities exploiting the society at large. The minorities are tiny both in relationship to the population of the society and also in relation to its wealth. If a group, even if few in numbers, owned most of the tangible capital in a country, it would use any organized power it had in ways consistent with the prosperity of the society, since its own members would encompass enough of the society's income-earning capacity to give them an incentive to choose socially-efficient policies.

In any given case of market combination or of special-interest lobbying, then, the problem is that a tiny minority, both in terms of voting power and of wealth, rips off the rest of the society in ways that reduce the efficiency and dynamism of the society. The vast majority of losers have incomparably more muscle-power, voting-power, and wealth than those who are ripping them off. If the victims of distributional coalitions had even a faint idea what was really going on, they would easily put a stop to it. They lose only because of their rational ignorance and the shortcomings of the ideologies they accordingly rely on.

Since minute minorities are the source of the problem, it follows that they will easily and quickly defeated if rational ignorance should be overcome. The minority that is the source of the problem in any given case is, moreover, so tiny that it will be normally be outnumbered if even an elite of two or three percent -- or often even less -- of the population

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[14]See "A Theory of the Incentives Facing Political Organizations: Neo-Corporatism and the Hegemonic State," International Political Science Review, Vol. 7, No. 2, April 1986, pp. 165-189.

comes to understand the problem. Thus there is reason to hope that on occasion socially useful ideas can triumph simply because their opposition, though organized, is weak.

Of course, all the tiny minorities add up to a majority and then some. But this is not a serious problem: in any society with narrow distributional coalitions, the members of each distributional coalition lose from the redistributions in favor of each of the other distributional coalitions and the inefficiencies and obstacles to innovation that attend these redistributions. Though rational ignorance shows up here too, it is nonetheless easy to find examples of distributional coalitions that try to counter the deadweight losses from some other distributional coalitions. One example is provided by the American Medical Association, which has taken an official stand against cartelization and restriction of entry by medical technicians and nurses. The fact that the AMA's preference for free entry and competition was not impartially applied to physicians themselves not only adds charm to the example, but also illustrates both the problem of institutional sclerosis and the possibility of getting a cure.[15]

Since any distributional coalition that systematically generates large social losses on any single issue or in any single market represents only a minuscule minority, any large random sample of the society's population will be composed mainly or totally of people who are not a part of this distributional coalition, even though they will often belong to some other distributional coalition. In this, they will be rather like a typical jury or judge. When a jury or judge is chosen, the jurors and the judge are unlikely to be relatives or friends of either the defendant or the prosecutor. If they are, there is a social consensus (as well as laws) that no juror or judge should be a relative or friend of any party to the case in question. Thus societies have for a long time been able to provide reasonably detached and impartial judges and juries for most court cases.

With this legal parallel in mind, let us now look at the journalists, politicians, economists, sociologists, political scientists, civil servants, and others with an occupational interest in public affairs. The typical person in any of these lines of work is likely to be as self-interested (and probably as unsuccessful in taking a detached view of this self-interest in disputes and debates about public policy) as a businessman or factory worker. People in these lines of work may very well also be typical members of aggressive distributional coalitions; the journalist or the academic, for example, may well belong to a lobbying group or a union for journalists or for academics. In general, society will lose as much from the operation of these coalitions as from those for other groups in the population.

But those professionals who are rewarded professionally for being informed about one

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[15]Unfortunately, a situation where all groups are organized and the depredations and efficiency losses from each coalition are resisted by another never arises (RADON, Implication 1, pp. 37-38), because some large groups have no access to selective incentives and can never organize.

aspect or another of public affairs, and who are (at least in some specialized area of the society's interest) therefore not rationally ignorant, will be relatively impartial about the claims and activities of most distributional coalitions other than their own, and about most public issues that do not relate in a singular way to their own occupation. Since these individuals normally have no important personal stake on most issues, they are usually motivated in large part by some broad public interest; their situations are much the same as those of jurors or judges. It would be going much too far, of course, to claim that a professional interest in public affairs prevents ideological bias. But most such biases grow out of one or the other of the familiar ideologies; the partisans of one ideology are largely countervailed by the adherents of the other, and expert opinion in the aggregate is surely influenced by evidence and argument.

Thus there are substantial numbers of individuals that, on most important public issues, have some incentive to be informed and are also relatively public spirited, or at least partial only to some relatively innocuous encompassing interest. It is in large part through such individuals that better ideas about economics and public policy can, and sometimes do, influence public policy. Some of the journalists write editorials, for example.

Though a few of the voters that read these editorials may cast their votes to serve some narrow vested interest, the average election is not mainly about any one narrow coalition's special interest. Thus most voters most of the time, although rationally ignorant, are motivated mainly by public spirit, or by relatively harmless encompassing purposes like favoring their own class. The masses, like the elites, are mainly innocent.

XVII

So ideas do, in spite of the influence of organized interests, have a great influence on the policies and institutions that societies choose. I think that the different ideas that, because of historical accidents, emerged in Britain and Spain in the seventeenth century, have continued to play a considerable role in explaining the difference in economic performance between the English-speaking and Spanish-speaking countries. Seventeenth century Spain passed mainly illiberal ideas on to the Spanish colonies. These ideas have made the Spanish-speaking countries more susceptible to protectionism and economic nationalism than the English-speaking nations have been. These ideas have also handicapped the advance of democracy in the Hispanic world.

As part One of this paper showed, protectionist barriers encourage special interest organization, and special-interest organizations generate not only more protectionism, but many other types of special interest legislation and regulation as well. If the prevailing ideas about what economic policy should be are not sound, the organized special interests do more damage than they would otherwise have done.

If the argument I have offered here is correct, it offers a promising opportunity for the nations of Latin America. If it is an unlucky inheritance of ideas from Spain, rather than any alleged deficiencies of the resources or peoples of Latin America, that explains the special economic problems of Latin America, then the countries of Latin America can greatly improve their performance by adopting more open and liberal policies. If elites in Latin America come to be persuaded of this, public policies will be changed, in spite of the power of organized interests.

The last few years have been a time of intellectual ferment in the Spanish-speaking world. Ideas are changing, and in my opinion changing for the better. If this change in ideas goes far enough, Latin America will overhaul its economic policies and institutions. This would bring about great economic development in Latin America.

It is, therefore, entirely possible that Latin America could be the scene of great economic progress in the coming years. It might even become the most dynamic and rapidly growing part of the world economy. Whether this will actually happen or not, no one can say. But I am confident that, with the right ideas and the right choices of institutions and policies, Latin America will become as prosperous as any other part of the world.