

Institutional Development in Developing Countries in a Historical Perspective.

Lessons from Developed Countries in Earlier Times

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1. Introduction

The issue of institutional development, especially under the slogan of “good governance”, has recently come to occupy the centre stage of development policy debate. During the last decade or so, the international financial institutions (henceforth IFIs) have come to recognise the limitations of their earlier emphasis on “getting the prices right” and have accepted the importance of the institutional structure that underpins the price system. Especially following the recent Asian crisis, which has been widely interpreted as a result of deficient institutional structure, the IFIs (and many donor governments) have started to put emphasis on “getting the institutions right” and attach what Kapur & Webb (2000) call “governance-related conditionalities”.

On the offensive these days are those who believe that every country should adopt a set of “best practice” institutions (unfortunately often implicitly equated with US institutions), with some minimal “transition” provisions for the poorest countries – various agreements in the WTO being the best example. And backing up such claim is a rapidly growing body of literature, especially from the World Bank and its associates, trying to establish statistical correlation between institutional variables and economic development, with the supposed causality running from the former to the latter (for a review of these studies, see Aron, 2000).¹

Exactly which are the institutions that go into the “good governance” package differ across recommendations, but frequently included in this package of “best practice” institutions are: democracy; clean and efficient bureaucracy and judiciary; strong protection of (private) property rights (including intellectual property rights); good corporate governance institutions (especially information disclosure requirements and bankruptcy law); well-developed financial institutions (see Kaufmann et al., 1999, and Aron, 2000). Less frequently included but still important are good public finance system (La Porta et al., 1999) and good social welfare and labour institutions providing “safety nets” and protecting workers’ rights (Rodrik, 1999b).

Critics argue that, apart from the fact that the IFIs do not have the mandate to intervene in most of these “governance” issues (e.g., Kapur & Webb, 2000), the institutions of developed countries can be too demanding for developing countries in terms of financial and human resource requirements. Some of them also argue that some of these institutions may go against social

¹ The institutional variables are often represented by various “indexes” constructed by consulting firms and research institutes based on surveys of experts or businessmen (for the details on these indicators, see Kaufmann et al., 1999).

norms and “cultural” values of some of the countries concerned. Many of these critics emphasise the difficulty of institutional transplantation and warn against the attempt to impose a common institutional standard on all countries with different conditions.

These critics have an important point to make, but in the absence of some idea as to which institutions are necessary and/or viable under what conditions, they are in danger of justifying whatever institutional *status quo* that exists in developing countries. Then what is the alternative?

One obvious alternative is for us to find out directly which of the “best practice” institutions are suitable for particular developing countries by transplanting them and seeing how they fare. However, as the failures of “structural adjustment” in many developing countries and of “transition” in many former Communist economies show, this usually does not work and can be very costly.

Another alternative is for the developing countries to wait for spontaneous institutional evolution. It may be argued that the best way to get the institutions that suit the local conditions is to let them evolve naturally, as indeed was the case with many developed countries when they were developing. However, such spontaneous evolution may take a long time. Moreover, given the nature of the evolutionary process, there is no guarantee that what you get through such process will be the best possible institutions, even from the national point of view.

These, then, point us to a third, and my preferred, alternative, which is to learn from history. Why not look at the developed countries when they were “developing countries” themselves and see how they have developed their institutions? In other words, we could draw lessons from the *history*, as opposed to the *current state*, of developed countries. This way, developing countries can learn from the experiences of developed countries without paying all the costs involved in developing new institutions (one of the few advantages of being a “late-comer”). This will also help the donors that want to encourage the adoption of particular institutions by the recipients of their aids to decide whether particular “we’re-not-ready-yet” kinds of argument put to them by some recipient country governments are reasonable or not.

Despite the obvious advantages of the historical approach, there is surprisingly little work along these lines, and the present paper is intended to fill this rather important gap.² In this paper, we conduct this exercise in the following way.

In section 2, we examine how various institutions that are currently regarded as essential components of a good governance structure evolved in the developed countries when they were developing countries themselves, mainly between the early 19th century and the early 20th century. We look at six broad areas – democracy (section 2.1), bureaucracy and judiciary (section 2.2), property rights (section 2.3), corporate governance (section 2.4), (private and public) financial institutions (section 2.5), and welfare and labour institutions (section 2.6).

Unfortunately, the examples used in section 2 are often confined to a few countries (especially the UK and the US) mainly due to the paucity of English-language sources on smaller European countries. We tried our best to amend this problem, by consulting at least some non-English sources, but it has to be admitted that further research is required to widen the coverage. Even with this limited coverage, section 2 is quite lengthy, partly because we cover quite a large number of institutions but also because the paths of institutional evolution in the currently developed countries had been quite complicated. Given this, it is recommended that those who are not so much interested in the details can

² Crafts (2000) is a notable exception, but it only covers the UK experience and is focused on financial and corporate governance institutions.

quickly skim through section 2 and move on to the next section, especially since section 3 provides a partial summary of what was presented in section 2.

In section 3 we see how institutional developments in the developed countries in the past compare with those of today's developing countries at comparable levels of development. This section provides some "panoramic" view of the process of institutional evolution in the developed countries in earlier times by offering 3 "snapshot" pictures (1820, 1875, and 1913). In section 4, we discuss the theoretical and the policy implications of our findings.

2. The History of Institutional Development in the Developed Countries

2.1. Democracy

When voting was first introduced in the now-developed countries (henceforth NDCs), it was confined to a very small minority of property-owning males (usually above 30), often with unequal number of votes according to the scale of property, educational achievement, or age.

For example, in France, between 1815 and 1830, the franchise was granted only to males above 30 and also paid at least 300 francs in direct taxes, which meant that only 80,000-100,000 out of a population of 32 million could vote. During 1830-1848, there was some relaxation of franchise requirements, but still only 0.6% of all Frenchmen could vote (Kent, 1939). In England before the Reform Act of 1832, which was the watershed event in the extension of suffrage in the country, it was widely agreed that landlords could decide 39 out of 40 county elections through their influence on the tenants, bribery, and patronage (Daunton, 1995, pp. 477-8). Even after the Reform Act of 1832, voting rights were extended from 14% to only 18% of the males, partly because many craftsmen and labourers with no or little property were disenfranchised, as the Act established a closer link between property and enfranchisement. In Italy, even after the lowering of voting age to 21 and the lowering of tax-paying requirements in 1882, only around 2 million men (equivalent to 7% of the population) could vote, due to (lower but still extant) tax payment and literacy requirements (Clark, 1996, p. 64).

It was not until 1848 when France introduced universal male suffrage that even limited forms of democracy began appearing among the NDCs. As we see in table 1, most NDCs introduced universal male suffrage between the mid-19th century and the first couple of decades of the 20th century. However, even this process was not without reversals.

Table 1. Introduction of Democracy in the NDCs

Country	Universal Male Suffrage	Universal Suffrage
Australia	1903*	1962
Austria	1907	1918
Belgium	1919	1948
Canada	1920 [#]	1970
Denmark	1849	1915
Finland	1919 [^]	1944
France	1848	1946
Germany	1849 [#]	1946
Italy	1919 ^{\$}	1946
Japan	1925	1952
Netherlands	1917	1919
New Zealand	1889	1907
Norway	1898	1913
Portugal	n.a.	1970
Spain	n.a.	1931
Sweden	1918	1918
Switzerland	1879	1971
UK	1918 ⁺	1928
USA	1870	1965

Sources: Therborn (1977) and Silbey (1995) for democracy indicators. Maddison (1995) for the income figures. For further details on universal suffrage, see table 3.

*With racial qualifications

[#]With property qualifications

[^]Communists excluded

^{\$}With restrictions

⁺All men and women over 30

For example, during the late 19th century, when an electoral victory by the Social Democratic Party became a possibility at least in local elections, Saxony abandoned universal male suffrage that had been adopted earlier and moved over to the Prussian-style three-class voting system (which Prussia itself used during 1849-1918) (Ritter, 1990, Kreutzer, 1996). In this system, each of the three classes (classified according to incomes) elected the same number of delegates to the parliament, which meant that the top two classes (each accounting for 3-5% and 10-15% of the population) could always outvote the poorest class. In 1909, Saxony moved further away from democracy by giving voters one to four votes according to their income and status. For example, those with a large farm gained three additional votes, and additional ballots were allotted to the well-educated and those over 50 years of age. In Spain, when the introduction of universal suffrage in 1931 resulted in a series of left or centre-left Republican governments, conservative forces reacted against it with a military coup in 1936, thus suspending democracy until the end of Franco dictatorship in 1977 (Linz, 1995; Carr, 1980).

Although male universal suffrage at least amongst the majority (white) population was attained in most NDCs by the end of the First World War, these countries could hardly be called democracies even in the purely formal sense of the word, because women and ethnic minorities were disenfranchised. It was not

until 1946 that the majority of the 19 NDCs featured in table 1 attained universal suffrage

Australia and New Zealand were the first countries to give women votes (1903 and 1907 respectively), although Australia did not enfranchise non-whites until 1962. Norway allowed votes for tax-paying women or women married to tax-paying men in 1907, although universal suffrage was only introduced in 1913 (Nerbørvik, 1986, p. 125). Women were allowed to vote only in 1920 in the USA and in 1928 in the UK. In many other countries, women were given votes only after the Second World War (for example, Germany, Italy, Finland, France, Belgium). In the Swiss case, female suffrage was granted about hundred years after the introduction of universal male suffrage (1879 vs. 1971).

In countries with significant non-white minority groups, there were racial restrictions. Australia restricted voting rights of non-whites until 1962. In the US case, even though the 15th Amendment to the Constitution gave blacks the vote in 1870, other obstacles (formal – literacy and “character” requirements – and informal – threats of violence) kept them from the ballot boxes until the Voting Rights Act of 1965 removed the formal fetters preventing the blacks from voting (Therborn, 1977; Silbey, 1995). Some countries also had restrictions based on political creed – Finland banned Communists from voting until 1944.

Even when the NDCs achieved formal democracy, its quality was often very poor, as in the case of many modern-day developing countries. We already have mentioned the “quality” problem relating to selective enfranchisement according to race, gender, and property ownership. But that was not all.

First of all, even secret balloting was not common until the 20th century. Norway, which was relatively progressed in terms of democratic institution by the standard of the time³, introduced secret balloting only in 1884 (Nerbørvik, 1986, p. 125). In Prussia, employers could exert pressure on their workers to vote in a particular way until the electoral reform of 1919 because balloting was not held in secret. France introduced voting envelope and voting booth only in 1913 – several decades after the introduction of universal male suffrage (Kreutzer, 1996).

Second, vote buying and electoral fraud were also very widespread. For example, bribery, threats, and promise of employment to voters were widespread in British elections until the introduction of the Corrupt and Illegal Practices Act in 1883. Although the stringency of the Act significantly reduced electoral corruption (e.g., those candidates convicted in election court were not allowed to run for elections ever again and barred from holding public offices for 7 years; O’Leary, 1962, pp. 174-5), the problem still persisted well into the 20th century, especially in local elections (Searle, 1979-80, and Howe, 1987).⁴ For another example, in the decades following the introduction of universal male suffrage in the USA, there were numerous cases involving the use of public officials for party political campaign (including forced donation to electoral campaign funds), electoral fraud, and vote-buying (Cochran & Miller, 1941, pp. 158-9; also see Benson, 1978).⁵

³ For example, already in 1814, about 45% men were able to vote in Norway (Nerbørvik, 1986, p. 119). Compare this with the figure for the UK, which was economically far more advanced (see table 4), that we cited above (18% in 1832).

⁴ The first serious attempt to control electoral corruption in the UK was the Corruption Practices Act of 1853-4 (O’Leary, 1962, pp. 23-4). This Act for the first time defined activities like bribery, “treating”, undue influence, and intimidation, while establishing election accounts and auditing. However, the measures remained ineffective (pp. 24-5).

⁵ It also involved the manufacture of aliens into citizens with bribery, which was done “with no more solemnity than, and quite as much celerity as, is displayed in

With such “expensive” elections, it was not a big surprise that elected officials were corrupt. In the late 19th century, legislative corruption in the US, especially in state assemblies, got so bad that Theodore Roosevelt lamented that the New York assemblymen, who engaged in open selling of votes to lobbying groups, “had the same idea about Public Life and Civil Service that a vulture has of a dead sheep” (Garraty & Carnes, 2000, p. 472).⁶

Thus seen, the road to democracy in the NDCs was a really rocky one. It was only through several decades of political campaign (e.g., campaign for female or black suffrage) and electoral reforms that these countries acquired even the basic trappings of democracy – universal suffrage and secret ballots – and even then its practice was filled with electoral fraud, vote-buying, and violence.

What is interesting to note is that, compared to the NDCs in their early stages of development, the currently developing countries have actually much better record in this regard. As we can see from table 2, no NDC granted universal suffrage below the level of \$2,000 per capita income (in 1990 international dollars), but the majority among the wide selection of currently developing countries featured in table 2 did so well below that level of development.

converting swine into pork in a Cincinnati packing house”, according to the *New York Tribune* newspaper in 1868 (Cochran & Miller, 1941, pp. 159).

⁶ Open sales of vote by them were especially widespread in the 1860s and the 1870s. The group of corrupt assemblymen from both parties, called “Black Horse Cavalry” demanded \$1,000 per vote on railroad bills and vigorous bidding drove prices up to \$5,000 per vote. The group also introduced “strike bills”, which if passed would hinder greatly some wealthy interests or corporation, and would demand payment to drop the bill. Some companies as a result created lobbying organisations that bought legislation, sparing themselves of blackmail. See Benson (1978, pp. 59-60 for details).

Table 2. Income per capita at attainment of universal suffrage

<i>GDP p.c. (in NDCs 1990 international dollars)</i>	<i>(Year universal suffrage was attained; GDP p.c.)</i>	<i>Developing Economies (Year universal suffrage was attained; GDP p.c.)</i>
<\$1,000		Bangladesh (1947; \$585 ⁷) Burma (1948; \$393 ⁸) Egypt (1952; \$542) Ethiopia (1955; \$295) India (1947; \$641) Indonesia (1945; \$514) Kenya (1963; \$713) Pakistan (1947; \$631 ⁹) South Korea (1948; \$777) Tanzania (1962; \$506) Zaire (1967; \$707)
\$1,000-\$1,999		Bulgaria (1945; \$1,073) Ghana (1957; \$1,159) Hungary (1945; \$1,721) Mexico (1947; \$1,882) Nigeria (1979; \$1,189) Turkey (1946; \$1,129)
\$2,000-\$2,999	Austria (1918; \$2,572) Germany (1946; \$2,503) Italy (1946; \$2,448) Japan (1952 ¹⁰ ; \$2,277) Norway (1913; \$2,275) Spain (1931; \$2,713) Sweden (1918; \$2,533)	Columbia (1957; \$2,382) Ireland (\$2,625) Peru (1956; \$2,732) Philippines (1981; \$2,526)
\$3,000-\$3,999	Denmark (1915; \$3,635) Finland (1944; \$3,578) France (1946; \$3,819)	Taiwan, Province of China (1972; \$3,313) Chile (1949; \$3,715)
\$4,000-\$4,999	Belgium (1948; \$4,917) Netherlands (1919; \$4,022)	Brazil (1977; \$4,613)
\$5,000-\$9,999	Australia (1962; \$8,691) New Zealand (1907 ¹¹ ; \$5,367) Portugal (1970; \$5,885) UK (1928; \$5,115)	Argentina (1947; \$5,089) Venezuela (1947; \$6,894)
>\$10,000	Canada (1970 ¹² ; \$11,758)	

⁷ GDP p.c. in 1948

⁸ GDP p.c. in 1950

⁹ GDP p.c. in 1948

¹⁰ Universal suffrage was granted in 1946 under the constitution drawn up by the occupying forces after the Second World War, but did not come into effect until the end of US military rule in 1952.

¹¹ When dominion status was achieved.

Switzerland	(1971;
\$17,142)	
USA (1965;	\$13,316)

Sources: Therborn (1977); *Elections* (1989); Maddison (1995)

2.2. The Bureaucracy and the Judiciary

2.2.1. The Bureaucracy

It is well known that at least until the 18th century, open sales of public offices (and honours) – sometimes with widely-publicised price tags – was a common practice in most NDCs (see Kindleberger, 1984, pp. 160-1 for England; pp. 168-9 for France). Partly because they were openly bought and sold, public offices were *formally* regarded as private property in many of these countries. For example, in France, it was very difficult to introduce disciplinary measures for bureaucrats until the Third Republic (1873) because of this reason (Anderson & Anderson, 1978). In Britain, prior to the reform in the early 19th century, government ministries were “private establishments” unaccountable to the Parliament, paid their staff by fees (rather than salaries), and kept many obsolete offices as sinecures (Finer, 1989). Associated with the sales of public offices was tax farming, which was most widespread in pre-Revolution France but was also practiced in other countries, including Britain and the Netherlands (see section 2.5.4 for further details).

The “spoils” system, where public offices were allocated to the loyalists of the ruling party, became a key component in American politics since the emergence of the two-party system in 1828 with the election of President Jackson. This got much worse for a few decades after the Civil War (Cochran & Miller, 1941, pp. 156-160; Garraty & Carnes, 2000, pp. 253-4; Finer, 1989). There was a loud cry for civil service reform throughout the 19th century to create a professional and non-partisan bureaucracy, but it got nowhere until the Pendleton Act of 1883 (Garraty & Carnes, 2000, p. 472, and pp. 581-3; see below for further details on the Act). Italy and Spain continued the spoils system throughout the 19th century (Anderson & Anderson, 1978).

In addition to the sales of public offices, there was widespread nepotism. Although concrete historical data on this is obviously difficult to come by, Armstrong (1973) reports that significant proportions of elite administrators in France and Germany had fathers who were top officials themselves, suggesting a high degree of nepotism. For instance, among the high-ranking bureaucrats of pre-industrial France (the early 19th century), about 23% had fathers who served as elite administrators. At the country’s industrial take-off in the mid-19th century, the proportion was still 21%. Corresponding figures for Prussia, where the nobility dominated high office, were 31% and 26% respectively. In Prussia, competition from educated lower-middle class men was eliminated by changing the entrance requirements, such that by the 1860s, “a carefully controlled recruitment process produced an administrative elite including the aristocracy and wealthier middle-class elements” (Armstrong, 1973, pp. 79-81).

With the sales of offices, spoils system, and nepotism, it was not a surprise that professionalism was conspicuously lacking in the bureaucracies of most NDCs at least until the late 19th century. The Jacksonians in the US had a contempt for expert knowledge and was against the professionalisation of the bureaucracy on the ground that more citizens should be able to participate in the act of government (Garraty & Carnes, 2000, p. 254). Even after the 1883 Pendleton Act, which set up the Civil Service Commission to administer competitive recruitment to the federal bureaucracy, only about 10% of civil service jobs were subject to competitive recruitment (Garraty & Carnes, 2000, p. 583). The Italian bureaucrats in the late 19th century had “no legal, or even

¹² When the Election Act that year granted full franchise.

conventional, guarantees on tenure, dismissals, pension, etc., and no recourse to the court" (Clark, 1996, p. 55).

It was only through a long drawn-out process of reform that the bureaucracies in the NDCs were modernised. The pioneer in this regard was Prussia, which by the early 19th century had already installed some key elements of a modern bureaucracy – entrance examination, hierarchical organisation, pension systems, disciplinary procedure, and security of tenure (Anderson & Anderson, 1978; also see Blackbourn, 1997, pp. 82-4).¹³ The Southern German states such as Bavaria, Baden, and Hesse, also made important progresses along this line during the early 19th century (Blackbourn, 1997, pp. 76-7).

In Britain, sinecures were eliminated through a series of reform between 1780 and 1834. Bureaucratic remuneration was changed from a fee-based system to a salary system in the first half of the 19th century. It was also only around this time that the status of government ministries in Britain was changed from "private establishments" to government ministries in the modern sense. The US made some important progress with professionalisation of the bureaucracy in the last two decades of the 19th century, as the proportion of federal government jobs subject to competitive recruitment rose from 10% at the introduction of the Pendleton Act in 1883 to nearly 50% by 1897 (Benson, 1978, p. 81, and p. 85).

2.2.2. The Judiciary

In the present "good governance" discourse, there is a strong emphasis on a "politically independent" judiciary administering "rule of law" (see Upham, 2000, for a critic of the "rule of law" rhetoric). However, we have to be somewhat careful in embracing this "independent judiciary" rhetoric. It may be argued that a judiciary that is too politically independent (e.g., the German and the Japanese systems) is not desirable, and that there should be some democratic political mechanisms to control their behaviour. This is why some countries have elected some of its judicial officials – the US of today (Upham, 2000) and the UK in the past (see below) being the best-known examples. In the UK, the boundary between the judiciary and the legislative is also blurred, since its highest judges sit in the House of Lords, but few people argue that this is a major problem.

Thus seen, we need to understand the quality of the judiciary not simply in terms of political "independence", but also in terms of a number of dimensions including the professionalism of the judicial officials, the quality of their judgments (not simply from a narrow "rule of law" point of view but also from a broader societal point of view), and the cost of administering the system.

Like their counterparts in modern day developing countries, the judiciary in many NDCs also suffered from excessive political influences, and corruption in appointments (or elections where applicable) until at least the late 19th centuries and often beyond. It was also frequently filled with men from a narrow privileged social background with little, if any, background in law, with the result that justice was dispensed often in biased and unprofessional ways.

In the UK, even the anti-corruption laws of 1853-4 and 1883 (see above) did not affect the election of Coroners, which was subject to widespread corruption and party political manouvring. Elections for County Coroners were abolished only in 1888, and it was not until 1926 that professional qualifications for County Coroners became compulsory (Glasgow, 1999). Germany made an impressive progress towards "rule of law" during the late 19th century and gained a largely independent judiciary by the end of the century. However, there was still lack of equality before law, with military and middle-class crimes getting less diligently brought to the court and less severely punished. This problem of "class

¹³ On the characteristics of the modern "Weberian" bureaucracy in the current developing country context, see Rauch & Evans (2000).

justice" equally dogged other NDCs at the time – the UK, the USA, and France (Blackbourn, 1997, p. 384). In Italy, at least until the late 19th century, judges did not usually have background in law, and "could not protect themselves, let alone anyone else, against political abuses" (Clark, 1996, p. 54).

2.3. Property Rights Regimes

Measuring the "quality" of a property rights regime is not easy, because it has numerous components – contract law, company law, bankruptcy law, inheritance law, tax law, and laws regulating land use (e.g., urban zoning laws, environmental standards, and fire safety regulations), just to name a few. In contemporary studies, this "aggregation problem" is got around by asking survey respondents to give a numerical value to the overall quality of the property rights institutions (e.g., "security of contract and property rights" or "enforcement of contracts or property rights"; see Aron, 2000, table 1, for some examples). However, even this inadequate "solution" to the problem is not available for historical comparison that we are attempting in this paper. Therefore, unlike in the case of other aspects of institutional development in this paper that are more, if not completely, "measurable" (e.g., democracy measured by the existence of universal suffrage, banking development measured by the existence of the central bank), we do not think it is possible to provide a generalised comparison of the quality of "property rights regimes" across time and countries.

However, there is one aspect of the property rights system that easily lends itself to this kind of analysis, which is that of intellectual property rights, with a small number of clearly identifiable laws (e.g., patent law, and to lesser extents, copyright law and trademark law). Therefore, in this section we provide a detailed empirical analysis of the evolution of intellectual property rights regimes in the NDCs in earlier times. However, before we do that, a few general theoretical comments on the role of property rights in economic development (with some historical references) are in order.

2.3.1. Some Misconceptions about Property Rights and Economic Development

Many people believe that the stronger the protection of property rights is, the better it is for economic development, as it encourages wealth creation. While it may be reasonable to argue that persistent uncertainty about the security of one's property rights is harmful for long-term investments and growth, the role of property rights in economic development is a lot more complex than what is suggested in this type of argument.

The point is that the security of property rights cannot be regarded as something good in itself. There are many examples in history where the preservation of certain property rights proved harmful for economic development and where the violation of certain existing property rights (and the creation of new property rights) were actually beneficial for economic development. The best known example is probably the Enclosure in Britain, which violated existing communal property rights by confiscation of commons but contributed to the development of woolen industry by promoting sheep farming on the land thus confiscated. De Soto (2000) documents how the recognition of squatter rights in violation of the existing property owners was crucial in developing the American West. Upham (2000) cites the famous Sanderson case in 1868, where the Pennsylvania Supreme Court over-rode the existing right of land owners to claim access to clean water in favour of the coal industry, which was a key industry of the state at the time. Land reform in Japan, Korea, and Taiwan, Province of China after the Second World War violated the existing property rights of the landlords but contributed to the subsequent development of these countries. For still another example, many people argue that the nationalisation of industrial enterprise in countries like Austria and France after the Second World War

contributed to their industrial development by transferring industrial property from a conservative and non-dynamic industrial capitalist class to the professional public sector managers with penchant for modern technology and aggressive investments.

The examples could go on, but the point is that what matters for economic development is *not* the protection of all existing property rights regardless of their nature, but which property rights are protected and which are not. If there are groups who are able to utilise certain existing properties better than their current owners, it may be better for the society not to protect the existing property rights and to create new ones that transfer the properties concerned to the former groups. With this general point in mind, let us take a detailed look at intellectual property rights institutions, as we promised earlier.

2.3.2. Intellectual Property Rights

The first patent system was invented in Venice in 1474 (it granted ten years' privileges to inventors of new arts and machines). In the 16th century, some German states, notably Saxony, used patents, although not totally systematically. The British patent law came into being in 1623 with the Statute of Monopolies, although many researchers argue that it did not really deserve the name of a "patent law" until its reform in 1852 (e.g., McLeod, 1988). France adopted its patent law in 1791, the USA in 1793, and Austria in 1794. Many of the other NDCs established their patent laws in the first half of the 19th century – Russia (1812), Prussia (1815), Belgium and the Netherlands (1817), Spain (1820), Bavaria (1825), Sardinia (1826), The Vatican state (1833), Sweden (1834), Württemberg (1836), Portugal (1837), Saxony (1843) (Penrose, 1951, p. 13). These countries established other elements of their intellectual property rights (henceforth IPR) regimes, such as copyright laws and trademark laws (first introduced in Britain in 1862), in the second half of the 19th century.

At this point, it should be noted that all of these early IPR regimes were highly "deficient" by the standards of our time. Patent systems in many countries lacked disclosure requirements, incurred very high costs in filing and processing patent applications, and afforded inadequate protection to the patentees. Few of them allowed patents on chemical and pharmaceutical substances (as opposed to the processes) – a practice that has continued well into the last few decades of the 20th century in many NDCs.¹⁴

Especially in relation to the protection of foreign IPR, which is becoming a major point of contention after the TRIPS (trade-related intellectual property rights) agreement in the WTO, these laws accorded only very inadequate protection (for further details, see Williams, 1896, Penrose, 1951, Schiff, 1971, McLeod, 1988, Crafts, 2000, and Sokoloff & Khan, 2000). For example, many of patent laws were very lax on checking the originality of the invention. More importantly, in most countries, including Britain (before the 1852 reform), the Netherlands, Austria, and France, patenting of *imported invention* by their nationals was often explicitly allowed. In the USA, before the 1836 overhaul of the patent law, patents were granted without any proof of originality. This not only led to the patenting of imported technologies but encouraged racketeers to engage in "rent-seeking" by patenting devices already in use ("phony patents") and by demanding money from their users under threat of suit for infringement

¹⁴ Chemical substances remained unpatentable until 1967 in West Germany, 1968 in the Nordic countries, 1976 in Japan, 1978 in Switzerland, and 1992 in Spain. Pharmaceutical products remained unpatentable until 1967 in West Germany and France, 1979 in Italy, and 1992 in Spain. Pharmaceutical products were also unpatentable in Canada into the 1990s. For details, see Patel (1989, p. 980).

(Cochran & Miller, 1942, p. 14).¹⁵ The cases of Switzerland and the Netherlands in relation to their patent laws deserve even greater attention (Schiff, 1971, for further details).

The Netherlands, which originally introduced a patent law in 1817, abolished it in 1869, partly due to the rather deficient nature of the law (even by the standards of the time)¹⁶, but also having been influenced by the anti-patent movement that swept Europe at the time. This movement condemned patents as being no different from other monopolistic practices (Schiff, 1971; Machlup & Penrose, 1951, documents the anti-patent movement of the time in detail).

Switzerland did not acknowledge any IPR over inventions until 1888, when a patent law protecting only mechanical inventions (“inventions that can be represented by mechanical models”; Schiff, 1971, p. 85) was introduced. Only in 1907, partly prompted by the threat of trade sanction from Germany in retaliation to the Swiss use of its chemical and pharmaceutical inventions, a patent law worth its name came into being. However, even this had many exclusions, especially the refusal to grant patents to chemical substances (as opposed to chemical processes). It was only in 1954 that the Swiss patent law only became comparable to those of other NDCs (Schiff, 1971), although chemical substances remained unpatentable until 1978 (Patel, 1989, p. 980).

With the introduction of IPR laws in an increasing number of countries, the pressures for an international IPR regime naturally started growing from the late 19th century (see Chang, 2000b, for further details). There were a series of meetings on this starting with the 1873 Vienna Congress, and the Paris Convention of the International Union for the Protection of Industrial Property was finally signed by 11 countries in 1883. The Convention covered not just patents but also trademark laws (which enabled patentless Switzerland and Netherlands to sign up to the Convention despite not having a patent law). In 1886, Berne Convention on copyrights was signed. The Paris Convention was subsequently revised a number of times (notably 1911, 1925, 1934, 1958, and 1967) in the direction of strengthening patentee rights and, together with the Berne convention, had formed the basis of the international IPR regime until the TRIPS agreement (Shell, 1998; see section 4).

However, despite the emergence of an international IPR regime, even the most NDCs were still routinely violating the IPR of other countries’ citizens well into the 20th century. We already mentioned that until this time, Switzerland and the Netherlands did not have a patent law. It is also interesting to note that the USA, a strong advocate of patentee rights even then, did not acknowledge copyrights of foreigners until 1891.¹⁷ And as late as in the late 19th century, when Germany was about to technologically overtake Britain, there was a great concern

¹⁵ According to Cochran & Miller (1942), therefore, the fact that between 1820 and 1830 the US produced 535 patents per year against 145 for Great Britain was mainly due to the difference in “scruples” (p. 14). Contrast this to the argument by Sokoloff & Khan (2000) that it was thanks to a “good” patent system that the US far exceeded Britain in patenting per capita by 1810 (p. 5).

¹⁶ The 1817 Dutch patent law did not require a disclosure of the details of patents. It allowed the patenting of imported inventions. It nullified national patents of inventions that acquired foreign patents. And there was no penalty on others using patented products without permission as far as it was for their own business (Schiff, 1971, pp. 19-20).

¹⁷ The US did not fully conform to the Berne Convention on international copyright (1886) until 1908, when the country finally abolished the requirement that copyrighted books had to be printed in the US or typeset with US plates (Sokoloff & Khan, 2000, p. 9).

in Britain with German violation of its trademarks (Williams, 1896, provides many interesting details; also see Landes, 1969, p. 328).¹⁸

Britain first introduced a trade mark law in 1862 (the Merchandise Mark Act), which banned “commercial thievery”, such as the forging of trademarks and the labeling of false quantities (Williams, 1896, p. 137). In the 1887 revision of the Act, mindful of German (and other foreign) infringement of the British trademark law, the British Parliament specifically added the place or the country of manufacture as a part of the necessary “trade description”. However, the Germans employed a range of measures to get around this Act (Williams, 1896, p. 138). They placed the stamp for the country of origin on the packaging instead of the individual articles, so that once the packaging was removed customers could not tell the country of origin of the product (said to be common amongst the imports of watches and files). They also sent some articles over in pieces and had it assembled in England (a method said to be common in pianos and cycles). They would also place the stamp for the country of origin where it is practically invisible.¹⁹

The above discussions show how deficient the IPR regimes of the NDCs were when they were developing by the standards that are demanded of the developing countries these days. Especially when it came to protecting the IPR of foreigners, there were widespread and serious violations at least until the late 19th century even in the most developed NDCs.

2.4. Corporate Governance

2.4.1. Limited Liability

Limited liability provides one of the most powerful mechanisms to “socialise risk” and therefore can be seen as the defining characteristic of a modern corporation (Rosenberg & Birdzell, 1986; Chang, 2000a). Kindleberger (1984) documents that in many European countries, limited liability companies under royal charter existed since the 16th century (p. 196). However, it was not until the mid-19th century that limited liability began to be awarded as a matter of course, rather than as a privilege.

For a long time, limited liability was often regarded with suspicion for its potential for creating “moral hazard” on the part of both the owners and the managers – Adam Smith argued that limited liability would lead to shirking by managers and the early 19th century economist John McCulloch argued that it would make the owners lax in monitoring the hired managers (Gillman & Eade, 1995). It was also believed to be an important cause of financial speculation. Britain banned the formation of new limited liability companies on this ground with the Bubble Act in 1720, although it was allowed again in 1825 with the repeal of the Act.

¹⁸ It is interesting to note that at the time the British were criticising Germany not only for using industrial espionage and the violation of trademark law but also for exporting goods made with convict labour (recall the recent US dispute with China on this account). On the other hand, exactly at the same time, the Germans were complaining about the absence of a patent law in Switzerland and the consequent “theft” of German intellectual property by Swiss firms, especially in the chemical industry.

¹⁹ “One German firm, which exports to England large numbers of sewing-machines, conspicuously labeled ‘Singers’ and ‘North-British Sewing Machines’, places the Made in Germany stamp in small letters underneath the treadle. Half a dozen seamstresses might combine their strength to turn the machine bottom-upwards, and read the legend: otherwise it would go unread” (Williams, 1896, p. 138)

Generalised limited liability was first introduced in Sweden in 1844. England followed this closely in the 1856 Joint Stock Company Act, although limited liabilities for banks (1857) and insurance companies (1862) were introduced only later, reflecting the then widespread concern that it could create some serious “moral hazard”. Rosenberg and Birdzell (1986) document how as late as in the late 19th century, decades after the introduction of the principle of limited liability, small businessmen “who, being actively in charge of a business as well as its owner, sought to limit responsibility for its debts by the device of incorporation” were frowned upon (p. 200). In Germany, a limited form of generalised limited liability was introduced in the 1850s, where the principal owners had unlimited liability but shares giving limited liability could be marketed (Tilly, 1994).

In the US, the first general limited liability law was introduced in the state of New York in 1811, but this law soon fell into disuse due to general apathy to limited liability companies (around 1816), and other states did not permit limited liability companies until 1837 (Garraty & Carnes, 2000, p. 244). Even after that, prejudices against limited liability companies prevailed at least until the 1850s, and as late as the 1860s, most manufacturing was done in unincorporated companies (pp. 231-2). There was still no federal law granting generalised limited liability (p. 362).

2.4.2. Bankruptcy Law

In the pre-industrial age, bankruptcy law was mainly regarded as establishing the procedures for the creditors to seize the assets of and to punish the “dishonest” and “profligate” bankrupt businessmen. In the UK, the first bankruptcy law, applicable to “traders” with above a certain amount of debt, was introduced in 1542, but became consolidated only with the 1571 legislation. However, the law was very harsh on the bankrupt businessmen, as all their future property was liable for former debts (Duffy, 1985, pp. 7-9).

With industrial development, there was an increasing acceptance that business can fail due to circumstances beyond individual control, and not just out of dishonesty or profligacy. And as a result, bankruptcy laws began to be seen also as a way of providing a clean slate for the bankrupts to try for a second chance. This transformation of bankruptcy law was, together with generalised limited liability, another key element in the development of the “socialisation of risk” that allowed greater risk-taking necessary for modern large-scale industries. For example, in 1705-6, measures were introduced in the UK to allow cooperative bankrupts to keep 5% of their assets and even discharged some from all future debts if the creditors consented (Duffy, 1985, pp. 10-12).

However, bankruptcy law in the UK still remained highly deficient by modern standards until at least the mid-19th century. Until then, bankruptcy remained the privilege of a very small class of wealthy businessmen, the responsibility for prosecuting laid entirely with the creditors, and the system was not uniform through the country (Duffy, 1985, pp. 16-7; Hoppit, 1987, pp. 35-7). There were also problems involved in the granting of “discharge” as it was granted by the creditors and not by courts, which prevented many businessmen from making a fresh start (Hoppit, 1987, pp. 32-3). There were also lack of professionalism and corruption among bankruptcy commissioners (pp. 33-5).

The Victorian age saw a series of reform of the bankruptcy law, starting with the establishment of the Bankruptcy Court in 1831. In the 1842 amendment, discharge became the right of courts, not creditors, making it easier for bankrupts to get a second chance (Duffy, 1985, pp. 52-3). However, the coverage was still limited until 1849, when the law became applicable to anyone who earned their living by “the workmanship of goods or commodities” (Marriner, 1980).

In the US, the early bankruptcy laws were modeled on the early (pro-creditor) English law and administered at the state level. However, only few states had bankruptcy laws and they varied from each other until the late 19th century (Coleman, 1974, pp. 6-16). There were a number of federal bankruptcy laws introduced along the 19th century (1800, 1841, and 1867), but they were all short-lived due to their defective nature (respectively repealed in 1803, 1841, and 1978) (the following details are from Coleman, 1974). For example, the 1800 law discharged many from their just debts incurred in turnpike and land speculation of late 1790s, and the relief it gave led to further speculation (pp. 19-20). The 1841 law was criticised for giving creditors just 10% of the estate, with most absorbed by legal and administrative costs. It was also criticised for the rule that property had to be sold immediately for cash, thus making the creditors get less value out of it (pp. 23-24). In the case of the 1867 law, courts could not cope with heavy caseload (in the first 4 years, there were 25,000 cases per annum). Another point of contention surrounding the law was the relaxation of requirement that bankrupts repaid at least half of their debts after Civil War, which attracted criticisms from creditors that the concession protected irresponsibility (pp. 24-6).

It was only in 1898 that the Congress was able to adopt a lasting federal bankruptcy law. The provisions in this law included: (a) relief of all debts, not just those after 1898; (b) permission of involuntary and voluntary bankruptcies; (c) exemption of farmers and wage-earners from involuntary bankruptcies; (d) protection of all properties exempted under state law from attachment; (e) granting of a grace period for insolvents to reorganise affairs or reach compositions with creditors.

2.4.3. Audit, Financial Reporting, and Information Disclosure

Institutions regulating financial reporting and disclosure requirements were still very poor even in the most developed NDCs well into the 20th century.

The UK made external audit of companies a requirement through the 1844 Company Act, but this was made optional again by the Joint Stock Company Act of 1856, against the recommendation by people like John Stuart Mill (Amsler et al., 1981). Given that limited liability companies need more transparency to control opportunistic behaviour by its dominant shareholders and hired managers, this was a significant step backward.

It was only with the introduction of the 1900 Company Act that external audit was made compulsory for British companies. However, there was no explicit requirement for firms to prepare and publish annual accounts for shareholders, although there was an implicit requirement for this as the auditor had the duty to report to shareholders. It was only through the 1907 Company Act that the reporting of a balance sheet was made compulsory. Even then, many companies exploited a loophole in the Act, which did not specify the time period for this reporting, and filed the same balance sheet year after year. It was only in 1928 that this loophole was closed. Through the 1928 Act, companies were made to file and circulate ahead of annual general meetings up-to-date balance sheets and disclose more detailed information (e.g., the composition of assets) (Edwards, 1981).

However, until the Companies Act of 1948, disclosure rules were still poor, turning the late Victorian market into a "market for lemons" (Kennedy, 1987, cited in Crafts, 2000). Crafts (2000) concludes that "the development capital markets based on extensive shareholder rights and the threat of hostile takeover is a relatively recent phenomenon in the UK even though the British were pioneers of modern financial reporting and had the Common Law tradition" (p. 5).

The USA made full disclosure to investors in relation to public stock offerings compulsory only after the 1933 Federal Securities Act (Atack & Passell, 1994; Garraty & Carnes, 2000, p. 750; see section 2.5.3. for further details). In Germany, it was only through the company law of 1884 that regulation regarding

the listing of companies in the stock markets was started (Tilly, 1994). In Norway, it was only with the legislation in 1910 that it was made the duty of companies to report their budgets and earnings twice a year to allow its shareholder (and the state) greater knowledge about its state of business (Norwegian government website: <http://www.lovddata.no>).

2.4.4. Competition Law

Contrary to what is assumed in much of the current “corporate governance” literature, corporate governance is not simply a matter internal to the corporation. When we have large firms whose actions can have unintended consequences for the whole economy (e.g., their bankruptcy can create financial panic) or undermine the basis of the market economy itself (e.g., “socially harmful” exploitation of monopoly position), corporate governance becomes a matter for the whole society, and not just for the shareholders of the company.

Moreover, corporate governance in this (social) sense does not simply involve company-level laws but a wide range of other regulations (e.g., sectoral regulations, regulations on foreign trade and investments) and informal practices (e.g., practices regarding the treatment of subcontractors) that regulate the behaviour of the companies. In the below, we review the evolution of most easily identifiable institution of “societal” corporate governance, namely, competition law (anti-monopoly and/or anti-trust legislation) in a number of NDCs, without necessarily presuming that a tougher anti-monopoly law is necessarily better.

France adopted Article 419 of the Penal Code as early as 1810 that outlawed coalitions of sellers that result in raising or lowering prices above or below those under “natural and free competition” (Cornish, 1979). The law was unevenly implemented according to the judge in charge of the case and gradually fell into disuse by 1880. From the 1890s, the French courts began to accept “defensive” combinations and to uphold their agreements (Cornish, 1979). It was not until 1986 that France repealed Article 419 and adopted a “modern” and a more comprehensive anti-trust law (Gerber, 1998, p. 36).

The USA was the pioneer in “modern” competition law. It introduced the Sherman Antitrust Act in 1890, although it was crippled by the Supreme Court in the notorious Sugar Trust case in 1895. Until 1902 when President Theodore Roosevelt used it against J.P. Morgan’s railways holding company, Northern Securities Company, the Act was in fact mainly used against labour unions, rather than against large corporations (Brogan, 1985, p. 458 and p. 464; Garraty & Carnes, 2000, p. 518 and p. 613). Roosevelt set up the Bureau of Corporations in 1905 to investigate corporate malpractice, which got upgraded into the Federal Trade Commission with the Clayton Antitrust Act of 1914, which also banned the use of antitrust legislation against the unions (Garraty & Carnes, 2000, p. 614 and p. 622).

Reflecting its *laissez faire* inclination during the 19th century, the British state neither supported or condemned trusts and other anti-competitive arrangements. However, until the First World War, the courts were quite willing to uphold the validity of restrictive trade agreements (Cornish, 1979). The first anti-trust initiative was taken was the short-lived Profiteering Act (1919, discontinued in 1921) intended to cope with postwar shortages (Mercer, 1995, pp. 44-6). During the Depression of the 1930s, the state endorsed rationalisation and cartelisation (pp. 49-50). It was only with the 1948 Monopolies and Restrictive Practices Act that a serious anti-monopoly/anti-trust legislation was attempted, but this Act remained largely ineffective (pp. 99-105). The Restrictive Practices Act of 1956 was the first true anti-trust legislation in the sense that it for the first time assumed that restrictive practices were against the public interest unless industrialists proved otherwise (pp. 125-6). The 1956 Act effectively countered cartels, but did not effectively counter monopolisation through merger (Hannah, 1979).

The German state initially strongly supported cartels and enforced their agreements during the early period of their existence (i.e., late 19th century and the early 20th century), the high point being the decision by the highest court in 1897 ruling that cartel is legal (Bruck, 1962, p. 93, 96; also see Hannah, 1979). From the First World War, cartelisation became widespread and became tools by which the government planned economic activities. The cartel law of 1923, which gave the court the power to nullify cartels, was the first general competition law in Europe (Bruck, 1962, pp. 196-7; Gerber, 1998, p. 115). However, the law remained ineffective, as it defined cartel very narrowly, and those who was given by this law the powers to control cartels – namely, the economic ministry and the cartel court – hardly used them (Gerber, 1998, pp. 129-131, p. 134). The cartel court was eliminated in 1930 when a series of emergency acts empowered the state to dissolve any cartel, and in 1933 the minister for economic affairs was given the power to nullify any cartel or decree the formation of compulsory cartels (Bruck, 1962, p. 197, p. 222; Gerber, 1998, p. 147).²⁰

In Norway, a Trust Law was first introduced in 1926, but the trust board in charge of it operated on the basis of the belief that it should monitor but not categorically prevent monopolistic behaviour. Although the law was subsequently replaced by the Price Law and the Competition Law in 1953, which had somewhat more stringent provisions (e.g., the companies now had to report major mergers and acquisitions), the main thrust of the Norwegian anti-trust policy remained that of publicity and control, rather than outright bans (Hodne, 1981, pp. 514-5). The Danish competition law of 1955 (the Monopolies and Restrictive Practices Act) operated on the same principle of “publicity and control” (Dahl, 1982, p. 298).

2.5. Financial Institutions

2.5.1. Banking

Banks in the NDCs became professional lending institutions only in the early 20th century. Before then, personal connections strongly influenced bank lending decisions. For example, throughout the 19th century, the US banks lent the bulk of money to their directors, their relatives, and those they knew

²⁰ It is well known that after the Second World War, Germany, together with Japan, was made to adopt a stringent US-style competition law by the American Occupation Authority. However, subsequent modifications of the law, especially in 1953, made collusive arrangements easier, especially among small firms when they are related to aims like “rationalisation”, “specialisation” (i.e., negotiated market segmentation), joint export activities, and structural adjustments (Shin, 1994, pp. 343-355).

(Lamoreaux, 1994).²¹ Scottish banks in the 18th century (Munn, 1981) and the English banks in the 19th century (Cottrell, 1980) were basically self-help associations for merchants wanting credit rather than banks in the modern sense.

The banking system got established only slowly in the NDCs (the details are from Kindleberger, 1984, unless otherwise specified). Even in England, a country with the most advanced banking system at least until the mid-20th century, a complete financial integration was achieved only in the 1920s, when deposit rates became uniform for town and country. In France, the development of the banking system was even more delayed, with widespread use of bank notes emerging only in the mid-19th century (as opposed to the 18th century in Britain) and with 75% of the population without access to banking until as late as 1863. In Prussia, there were no more than a handful of banks until the 18th century, and first joint stock bank was founded only in 1848 (Tilly, 1994). In Sweden, banks appeared only in the late 19th century (a major expansion in 1870), prior to which credits to producers and exporters were provided by merchant trading houses.

Banking regulation was highly inadequate, with the USA permitting "wildcat banking", especially between the demise of the Second Bank of the USA, the second quasi-central bank (see section 2.5.2) in 1836 and 1865, which were "little different in principle from counterfeiting operations" (Atack & Passell, 1994, pp. 103). Although the overall cost of failures of unregulated banks at the time is estimated to be small, bank failures were widespread (p. 104). Even as late as 1929, the US banking system was made up of "thousands upon thousands of small, amateurishly managed, largely unsupervised banks and brokerage houses" (Brogan, 1985, p. 523). This meant that even during the prosperity during the Coolidge presidency (1923-9), 600 banks failed in a year (Brogan, 1985, p. 523).

In Germany, direct regulation on commercial banks was introduced only in 1934 with the Credit Control Act (Tilly, 1994). In Italy, there was a huge scandal in the late 19th century (1889-92), where the bankruptcy of one of the six note-issuing banks, Banca Romana, revealed a web of corruption (extension of credits to important politicians and their relatives, including two prime ministers), defective accounting system, and "irregular" issue of bank notes (e.g., duplicate notes) in the heart of the country's banking industry (Clark, 1996, pp. 97-9).

2.5.2. Central Banking

Central banking, which is a fundamental plank in the modern financial system, was also an institution that came into being rather late in the development of the NDCs (the following details are from Kindleberger, 1984, and Cameron, 1993). The Swedish Riksbank was nominally the first official central bank in the world (established in 1688) (Kindleberger, 1984, p. 50), but until the mid-19th century, it could not function as a proper central bank because it did not have, among other things, monopoly over note issue (Larsson, 1993, pp. 47-8). The Swedish central bank gained note issue monopoly only in 1904 (Swedish Central Bank website: <http://www.riksbank.se>).

Bank of England was established in 1694 and started assuming the role of the lender of last resort from the 18th century (although in some people's view only in the first half of the 19th century), but only became a full central bank in 1844 (Kindleberger, 1984, pp. 90-92; pp. 277-280). The French central bank, Banque de France, was established in 1800, but gained monopoly over note issue only in 1848. The Banque de France was, however, basically controlled by the bankers themselves rather than the government until 1936 (Plessis, 1994).

The central bank of the Netherlands, the Nederlandsche Bank, was established in 1814 by King William I, modeled after the Bank of England, but

²¹ However, Lamoreaux (1994) argues that, given the high degree of competition and low leverage level prevailing in the US banking industry, this practice was beneficial.

was struggling to get its notes widely circulated until the 1830s and remained an Amsterdam-based “local” bank until the 1860s (‘T Hart et al., 1997, p. 4; Jonker, 1997, p. 95). The Spanish central bank, Bank of Spain, was established in 1829 but did not gain monopoly over note issue until 1874. The German central bank was established only in 1871 and gained monopoly over note issue only in 1905. In Italy, the central bank was set up only in 1893 and did not get monopoly over note issue until 1926. The Swiss National Bank was formed only in 1907 by merging four note-issue banks.

In the US, the development of central banking was even slower. The earlier attempts to introduce even a limited degree of central banking failed quite spectacularly – the First Bank of the USA established in 1791 failed to get its Charter renewed in the Congress in 1811 and the Second Bank of the USA established in 1816 met the same fate in 1836 (Atack & Passell, 1994; Brogan, 1985, p. 266 and p. 277). The US Federal Reserve System came into being only in 1913 through the Owen-Glass Act, which was prompted by the spectacular financial panic of 1907. Until 1915, however, only 30% of the banks (with 50% of all banking assets) were in the system, and even as late as 1929, 65% of the banks were still outside the system, although by this time they accounted for only 20% of total banking assets (Cochran & Miller, 1941, p. 295). This meant that in 1929 the law “still left some sixteen thousand little banks beyond its jurisdiction. A few hundred of these failed almost every year” (Cochran & Miller, 1941, p. 295). Also, until the Great Depression, the Federal Reserve Board was *de facto* controlled by the Wall Street (Brogan, 1985, p. 477).²²

In table 3 below, we present a summary of the above descriptions on the evolution of central banks in the NDCs. The first column represents when these institutions were established and the second column represents when they became a proper central bank by gaining note issue monopoly and other legal backings. The table shows that although 5 out of the 9 countries in the table nominally had a central bank by the 1830s, it was not until the early 20th century that these banks became “true” central banks in the majority of the countries.

Table 3. Development Central Banking in the NDCs

	Year of Establishment	Year when Note Issue Monopoly was gained
Sweden	1688	1904
UK	1694	1844
France	1800	1848*
Netherlands	1814	After the 1860s
Spain	1829	1874
Germany	1871	1905
Italy	1893	1926
Switzerland	1907	1907
USA	1913	After 1929**

*controlled by the bankers themselves until 1936.

**65% of the banks accounting for 20% of banking assets were outside the Federal Reserve System until 1929.

²² The most telling evidence is the story of Charles E. Mitchell, head of the National City Bank and a director of the Federal Reserve Bank of New York, who, in an attempt to minimise damage on his speculative activities in the run-up to the Great Depression, successfully put pressure on the Federal Reserve Board to reverse its policy of monetary tightening announced in early 1929 (Brogan, 1985, pp. 525-6).

2.5.3. Securities Regulation

The early development of securities market in the UK (established in 1692) led to an early emergence of securities regulation. The first such attempt to was made in 1697, which limited the number of brokers through licensing and capped their fees (Banner, 1998, pp. 39-40). In 1734, the Parliament passed the Barnard's Act, which tried to limit the more speculative end of the securities market by banning options, prohibiting parties from settling contracts by paying price differentials, and stipulating that stocks actually had to be possessed if the contracts that had led to their sales were to be upheld in courts (pp. 101-5). However, the law remained ineffective and was finally repealed in 1860 (pp. 109-110).

Except for the Banking Companies (Shares) Act, which forbade short-selling of bank shares (but not those of other companies) in 1867, which remained ineffective anyway (Pennington, 1990, p. 31), there was little attempt at securities regulation after the repeal of the Barnard's Act in 1860 until 1939, when the Prevention of Fraud (Investments) Act was legislated. The Act introduced a licensing system for individuals and companies dealing with securities by the Board of Trade, which had the power to revoke or refuse to renew license if the party gave false or inadequate information in application for the license or when trading (pp. 38-41). The Act was strengthened over time, with the granting of empower the Board of Trade to establish the rules as to the amount of information that dealers had to give in offers of sales (in 1944) and to appoint inspectors to investigate the administration of unit trusts (in 1958) (pp. 41-2).²³

In the US, organised securities market dated from the 1770s. The early attempts at regulation was directed against insider trading. For example, in 1789, the US Congress passed a bill banning Treasury officials from speculating in securities – even before the UK introduced such legislation (Banner, 1998, pp. 161-3). Although the Federal government made periodic threats to introduce securities regulation, securities regulation was left to the individual states throughout the 19th century (Banner, 1998, pp. 170-1, p. 281). However, not all states had laws regulating securities transaction (Pennsylvania, one of the most economically important states of the time, being the best example), and what law there was weak in letters and even weaker in enforcement (pp. 174-5).

Fraud in securities transaction, especially misrepresentation of information, was made a property fraud in the mid-19th century, but full information disclosure was still not mandatory (this had to wait until the 1933 Federal Securities Act). In the early 20th century, 20 states instituted "blue sky laws", which required investment bankers to register securities with state authorities before selling them and penalised misrepresentation, but the laws were ineffective there were many loopholes (Geisst, 1997, p. 169, p. 228). The US had to wait until the 1933 Federal Securities Act to have an effective federal securities regulation, which gave the Federal Trade Commission the authority to regulate security transactions – an authority that was then transferred to the new Securities and Exchange Commission in 1934 (Atack & Passell, 1994; Garraty & Carnes, 2000, p. 750).

2.5.4. Public Finance Institutions

²³ It was only with the 1986 Financial Services Act that the UK introduced a comprehensive securities regulation (brought into force on 29 April 1988). This Act required official listing of investments on the stock exchange and the publication of particulars before any listing, and established criminal liability of those who gave false or misleading information. It also prohibited anyone from conducting investment business unless authorised (Pennington, 1990, pp. 54-5).

In the early days of their development, the NDCs suffered from very limited fiscal capabilities. Their power to tax was so limited that tax farming was widely accepted as a cost-effective means to raise government revenue in the 17th and the 18th century (Kindleberger, 1984, pp. 161-2 for Britain, and pp. 168-170 for France; 'T Hart for the Netherlands, 1997, p. 29). Many contemporaries justified it as a way of saving administrative costs, stabilising revenue, and reducing corruption in tax collection (Kindleberger, 1984, p. 161), which were probably not unreasonable arguments, given the poorly developed public finance institutions in these countries at the time.

Overall, government finance, especially local government finance, in many NDCs was in a mess during most of the time that we are looking at. A telling example is the defaults by a number of US state governments on British loans in 1842, after which the British investors put pressure on the US federal government to assume the liabilities (which reminds us of the recent events in Brazil following the default of the state of Minas Gerais). When this pressure came to naught, the *Times* poured scorn on the US federal government's attempt to raise a new loan later in the year by arguing that "[t]he people of the United States may be fully persuaded that there is a certain class of securities to which no abundance of money, however great, can give value; and that in this class their own securities stand pre-eminent" (cited in Cochran & Miller, 1941, p. 48).

What especially exacerbated public finance of the time was the combination of frequent wars, which required a large extra public financing, and the inability to collect direct taxes (di John & Putzel, 2000). The absence of direct taxation partly reflected the political under-representation of the poorer classes but also the limited administrative capability of the bureaucracy.

Income tax was initially used only as an emergency tax intended for war financing. Britain introduced graduated income tax in 1799 to finance the war with France, but scrapped it with the end of the war in 1816 (Booney, 1995, pp. 443-5; Deane, 1979, pp. 228-9). Britain made income tax permanent only in 1842, but it was much opposed as an unequal and intrusive measure (Bonney, 1995).²⁴ Denmark introduced a permanent progressive income tax in 1903, although it had used the tax for emergency finance before (during the 1789 Revolutionary War and the 1809 Napoleonic War) (Mørch, 1982, pp. 160-1).

In the US, the introduction of income tax was even slower. The income tax law of 1894 was overturned as "unconstitutional" by the Supreme Court. A subsequent bill was defeated in 1898, and the Sixteenth Amendment allowing federal income tax was adopted only in 1913 (Baack & Ray, 1985). In Spain, the first attempt to introduce income tax as late as in 1926 by the Finance Minister Calvo Sotelo was thwarted by a campaign against it "led by the aristocracy of the banking world" (Carr, 1980, p. 101). In Sweden, despite its later fame for the willingness to impose high rates of income tax, income tax was first introduced only in 1932 (Larsson, 1993, pp. 79-80).

2.6. Social Welfare and Labour Institutions

2.6.1. Social Welfare Institutions

Before the 1870s, social welfare institutions in the NDCs were very poor, with the English Poor Law-type legislation at their core. The poor relief laws of the time stigmatised the recipients of state help, with many countries depriving them of voting rights (Pierson, 1998, pp. 106-7). For example, Norway and Sweden introduced universal male suffrage respectively in 1898 and 1918, but it was not

²⁴ The influential economist of the time, John McCulloch argued that income taxes "require a constant interference with, and inquiry into the affairs of individuals, so that, independent of their inequality, they keep up a perpetual feeling of irritation" (Bonney, 1995, p. 434).

until 1918 and 1921 respectively that those who had received state assistance were enfranchised (Pierson, 1998, p. 107).

As we can see in table 4, social welfare institutions in the NDCs started to emerge only in the late 19th century, spurred by the increasing political muscle-flexing of the popular classes after the significant extension of suffrage during the time (see section 2.1 for further details on the extension of suffrage). Of course, there was no one-to-one relationship between the extension of suffrage and the extension of welfare institutions. While in cases like New Zealand, there is a clear link between the early extension of suffrage and the development of welfare institutions, in cases like Germany, welfare institutions grew quickly under relatively limited suffrage. In fact, Germany was the pioneer in this area. It was the first to introduce industrial accident insurance (1871), health insurance (1883), and state pensions (1889), although France was the first country to introduce unemployment insurance (1905) (Pierson, 1998, p. 105, table 4.2).

Table 4. Introduction of social welfare institutions in the NDCs

	Industrial Accident	Health	Pension	Unemployment
Belgium	1903	1894	1900	1920
Netherlands	1901	1929	1913	1916
France	1898	1898	1895	1905
Italy	1898	1886	1898	1919
Germany	1871	1883	1889	1927
Ireland	1897	1911	1908	1911
UK	1897	1911	1908	1911
Denmark	1898	1892	1891	1907
Norway	1894	1909	1936	1906
Sweden	1901	1891	1913	1934
Finland	1895	1963	1937	1917
Austria	1887	1888	1927	1920
Switzerland	1881	1911	1946	1924
Australia	1902	1945	1909	1945
New Zealand	1900	1938	1898	1938
Canada	1930	1971	1927	1940
USA	1930	No	1935	1935

Source: Pierson (1998), p. 104, Table 4.1.

Note: The figures include schemes which were initially voluntary but state-aided as well as those that were compulsory.

Social welfare institutions made impressive progress in the NDCs during the half century between the last quarter of the 19th century and the first quarter of the 20th century. In 1875, none of the 18 countries listed in table 4 had any of the 4 welfare institutions covered in the table, except for industrial accident insurance introduced in Germany in 1871. However, by 1925, 16 had industrial accident insurance, 13 had health insurance, 12 had pension, 12 had unemployment insurance.

2.6.2. Institutions Regulating Child Labour

As it is well known, child labour was widespread in the NDCs during the earlier days of their industrialisation. In the 1820s, it was reported that the British children were working between 12.5 and 16 hours (Hammond & Hammond, 1995, p. 169). Between 1840 and 1846, children under 14 accounted for up to 20% of the factory workforce in Germany (Lee, 1978, p. 466). In Sweden, as late as 1837, children younger than 5 or 6 could still be employed (Montgomery, 1939, pp. 219-222). In the USA, child labour was very widespread

in the early 19th century (in the 1820s, about half of cotton textile workers were under 16).²⁵ As late as 1900, more children under 16 in the US were working full time (1.7 million) than the whole membership of the American Federation of Labour, the country's then main trade union (Garraty & Carnes, 2000, p. 229 and p. 600).

In Britain, the first attempts to introduce institutions regulating child labour met with stiff resistance. For example, in the debate surrounding the 1819 Cotton Factories Regulation Act, which banned the employment of children under the age of 9 and restricted children's working hours, some members of the House of Lords argued that "labour ought to be free" and others arguing that children are not "free agent" (Blaug, 1958). The earlier laws (1802, 1819, 1825, and 1831) remained largely ineffective, partly because the parliament would not vote for the money needed for its implementation (Marx, 1976, p. 390). For example, the 1819 Act secured only 2 convictions by 1825 (Hammond & Hammond, 1995, p. 153-4).

The first serious attempt to regulate child labour in Britain was the 1833 Factory Act, but it covered only cotton, wool, flax, and silk industries (the following details are from Marx, 1976, pp. 390-1 unless otherwise specified; also see Mathias, 1969, pp. 203-4, for further details). This Act banned the employment of children under 9, and limited the working day of children between 9 and 13 to 8 hours and that for "young persons" (those between 13 and 18) to 12 hours. Children were not allowed to work during the night (between 8:30pm and 5:30am). In 1844, there was another Factory Act, which reduced the working hours of children under 13 to 6.5 (or 7 under special circumstances, and made provisions for compulsory mealtimes (p. 394). However, this was partly countered by the lowering of the minimum working age from 9 to 8 (p. 395). The 1847 Factory Act (the "Ten Hours Act") reduced the working day of children between 13 and 18 to 10 hours.

Since 1853, a series of other industries were brought under the Acts (which all functioned simultaneously, as far as they did not overlap), with the 1867 Act being the most significant in this respect (Hobsbawm, 1999, p. 103). The working hours of children employed in mines were, however, brought under the Factory Act only in 1872 (p. 634). Even in the 1878 Factory and Workshop Act, children over the age of 10 were allowed to work up to 30 hours, with the conditions less stringent in non-textile factories (pp. 635-6, footnote 47).

In Germany, Prussia introduced the first law on child labour in 1839. This law forbade the "regular" employment of children under 9 and illiterate children under 16 in factories and mines (Lee, 1978, p. 467). In 1853-4, factory inspection was instituted with the legal minimum age raised to 12, and the law became enforced to some extent. However, it was only until 1878 when the law strengthened inspection that child labour under 12 finally became illegal (p. 467). In Saxony, child labour under 10 was outlawed in 1861, and in 1865, the minimum working age for children was raised to 12 (p. 467). In Sweden, a law was passed in 1846 to ban labour by children under 12 and a law in 1881 restricted children's working day to 6 hours (Hadenius et al., 1996, p. 250). However, these laws were widely violated until a special supervisory agency was established to police these laws in 1900, a year when the maximum working hours for children between 13 and 18 were reduced to 10 hours (Montgomery, 1939, pp. 225-6).

²⁵ At the time, it was very common for families to be hired as a unit. In 1813, a cotton manufacturer advertised in a New York state provincial paper, *Utica Patriot*, that "[a] few sober and industrious families of at least five children each, over the age of eight years are wanted at the Cotton Factory". See Garraty & Carnes (2000, p 227, f.n. 1).

In Denmark, the first regulation on child labour was introduced in 1873, where the employment of children under 10 in industry was banned, with the maximum working hours of the age groups 10-14 and 14-18 set at 6.5 and 12 respectively. In 1925, it was legislated that children under the age of 14 that hadn't legally finished their schooling could not be employed, but this law exempted agriculture, forestry, fishing and sailing from the provision. The passing of the 1925 law was relatively easy, as at the time the Danish parliament was dominated by agricultural interests, who did not mind as long as the legislation didn't effect the agricultural sector (Mørch, 1982, pp. 364-7).

In Norway, the first legislation to regulate child labour was introduced in 1892 (Nerbørvik, 1986, p. 210). Through this law, children below 12 were forbidden to work, work by children between 12 and 14 was heavily regulated, and the working day for those between 14 and 18 was restricted to 10 hours. Night shift by those who are under 18 was banned, except for factories engaged in round-the-clock operation. In Italy, a law prohibiting employment of children under 12 was introduced only in 1902 (Clark, 1996, p. 137).

In the USA, thanks to the initiative taken by the National Child Labour Committee, nearly every state introduced laws banning the employment of young children and limiting the hours of older ones between 1904 and 1914, but they were poorly enforced (Garraty & Carnes, 2000, p. 607). The Congress passed a federal child labour law in 1916, but the Supreme Court declared it unconstitutional in 1918 (Garraty & Carnes, 2000, p. 607). A federal legislation banning child labour had to wait until 1938 when the Fair Labour Standard Act was introduced (Garraty & Carnes, 2000, p. 764).

2.6.3. Institutions Regulating Adult Working Hours and Conditions

In most NDCs, extremely long working hours were common throughout the 19th century. In the UK, the normal working day exceeded 12 hours before the 1844 Factory Act. In the US, until as late as the 1890s, only a small number of enlightened employers were willing to go below the customary 10-hour working day (Cochran & Miller, 1941, p. 245), and many recent immigrant workers worked for up to 16 hours a day throughout the 19th century (Cochran & Miller, 1941, p. 65). In Germany, the average workweek was 75 hours between 1850 and 1870, 66 hours in 1890, and 54 in 1914 (Lee, 1978, pp. 483-4). The workday for bakers in Norway during the 1870s and the 1880s lasted up to 16 hours (Pryser, 1985, pp. 194-5). In Sweden, the average working day was 11-12 hours until the 1880s, and until the 1900s, the working day could be as long as 17 hours in certain occupations, especially baking (Hadenius et al., 1996, p. 250). Mørch (1982) estimates that the Danish workweek was about 70 hours (10.5 hours for 6.5 days) in 1880 (p. 17).

Despite these extremely long hours, legislations regulating the working hours of the adult workers did not begin until the mid-19th century. One of the earliest attempts to control adult working hours was the 1844 Factory Act in Britain, which, among other things, restricted the working hours of women (over 18) to 12 hours and banned night-work for them (Marx, 1976, p. 394; the citations in the rest of the paragraph are from the same source unless otherwise specified). Although not legally stipulated, the socially-acceptable working hours of adult male workers also came down to 12, following this Act (p. 395). The 1847 Factory Act (came into force in 1848) restricted the working days for women (and children) to 10 hours (p. 395; also see Hobsbawm, 1999). However, many legal loopholes were exploited by many employers to minimise the impact of such legislation (Marx, 1976, pp. 398-9). For example, many employers did not allow mealtimes during the working day – between 9am and 7pm.

In the US, restrictions on working hours were first introduced at the state level, with Massachusetts introducing a pioneer legislation in 1874, which limited the working day of women and children to 10 hours a day (Garraty & Carnes,

2000, p. 607; all the information in the rest of the paragraph come from the same source). It was not until the 1890s that such legislation became common across the states. Around the turn of the century, some states also restricted the length of the workday in special industries like railways and mining, where fatigue can lead to major accidents. However, before 1900 “the collective impact of such legislation was not impressive”, especially because many conservative judges tried to limit its application (p. 607). For example, in 1905, the US Supreme Court declared in the famous *Lochner vs. New York* case that a ten-hour act for the bakers introduced by the New York state was unconstitutional because it “deprived the banker of the liberty of working as long as they wished” (p. 607). As late as 1908, an Oregon law limiting women laundry workers to ten hours was contested in the Supreme Court, although in this case the Court upheld the law (p. 608).

It was only by 1910 that most states in the USA “modified the common-law tradition that a worker accepted the risk of accident as a condition of employment and was not entitled to compensation if injured unless it could be proved that the employer had been negligent” and adopted accident insurance plans (Garraty & Carnes, 2000, p. 607). However, at the time safety laws were still very poorly enforced (Garraty & Carnes, 2000, p. 600), and federal industrial accident insurance was established only in 1930 (see table 4).

The information on other NDCs are more fragmentary, but it seems reasonable to say that even minimal regulations on working hours in many NDCs did not come about in many NDCs until the late 19th century or even the early 20th century. In Norway, a 10-hour workday was introduced only in 1887 (Nerbørvik, 1986, p. 210). In Italy, female working hour was restricted to 11 hours only in 1902, and a compulsory weekly rest day was introduced only in 1907 (Clark, 1996, p. 137).

It was only well into the 20th century that we are beginning to witness “modern” regulations on working hours. In Sweden, the 48-hour workweek was introduced in 1920 (Norborg, 1982, p. 61). Denmark also made the 8-hour workday compulsory in 1920, but agriculture and the maritime industry, which together employed about 1/3 of the labour force, was exempt from the law (Mørch, 1982, pp. 17-8). It was only with the Fair Labour Standards Act in 1938 that the maximum workweek of 40 hours was implemented in the USA (p. 764).

3. Institutional Development in Developing Countries Then and Now

So what can we say about institutional development among the now-developed countries (NDCs) in the early days of their development? In this section, drawing on our discussion in section 2 (the Appendix Table provides a tabular summary of our discussion in section 2, admittedly with a large element of unavoidable subjective judgments), we try to answer this question.²⁶

We do this by providing snapshot pictures for 3 points at different stages of development in the NDCs. We look at: 1820 for the early days of industrialisation even in the most advanced NDCs; 1875 for the height of industrialisation in the more advanced NDCs and the beginning of industrialisation in the less developed NDCs; and 1913 for the beginning of industrial maturity in the more developed NDCs and the height of industrialisation in the less developed NDCs.

²⁶ Obviously, a generalisation in this context is hazardous given the paucity of historical records (especially for the smaller countries) and the differences across countries. However, such generalisation may not be unacceptable for the purpose of the present paper.

3.1. 1820 – Early Industrialisation

In 1820, none of the NDCs had even universal *male* suffrage. Only men with substantial property (often over 30) could vote, if anyone was allowed to vote at all. In all these countries, nepotism, spoils, sinecures, and sales of office were common in bureaucratic appointments. Public office was often treated as private property, and salaried professional bureaucracy in the modern sense did not exist in most countries (Prussia and some other German states being notable exceptions).

Especially in new countries like the USA, existing property rights had to be routinely violated to make room for new property rights. Only a handful of countries had patent laws (UK, USA, France, and Austria) and their qualities were still very low, with virtually no check on the originality of inventions for which patents are sought. The emergence of the first of what even approximated “modern” patent law had to wait another decade and half (the 1836 revision of the US patent law).

Limited liability, a key institutional condition for the development of the modern corporation, was not a generalised institution and therefore a privilege rather than a right. Even the countries with the most developed corporate financial systems did not have regulations requiring external audit or full information disclosure. Bankruptcy laws, if they existed, were highly deficient as it covered only a limited class of business and were still limited in their ability to “socialise risk” by “wiping the slate clean” for the bankrupts. Competition law was all but non-existent, a limited and poorly-enforced example being the Clause 419 in the French Penal Code legislated in 1810.

Banks were still a novelty except perhaps in the UK, and none of the countries had a proper central bank with monopoly over note issue and the lender-of-last-resort function. Securities market regulation existed in few countries, was highly inadequate, and was rarely enforced. None of the countries had income tax except as an “emergency” measure during wars (e.g., Britain during 1799-1816, Denmark during the Napoleonic War).

None of the NDCs, in addition, had social welfare institutions or labour regulations on working hours, child labour, or health and safety at work – except for one or two minimal and ineffective laws regulating child labour in the UK (the 1802 law and the 1819 law).

3.2. 1875 – Industrialisation in Full Swing

By 1875, with the progress of industrialisation, the NDCs experienced considerable institutional development, but the quality of their institutions were still well below what we expect from the developing countries of today at comparable levels of development.

None of them had universal suffrage, although a few of them achieved universal male suffrage at least formally (France, Denmark, and the USA). Even in the latter countries, however, some basic institutions of democracy such as secret balloting were missing and electoral fraud was widespread – not to speak of the *de facto* banning of black voting in certain parts of the USA. Bureaucracies barely acquired key modern features (e.g, meritocratic recruitment, disciplinary measures) only in a few pioneer countries, especially Prussia and Britain (but not, for example, in the USA), and spoils system was still widely used.

Most of the NDCs may have instituted patent laws by this time (Switzerland and the Netherlands being the most famous exceptions), but the quality of these laws was still low. Partly because there was no international intellectual property rights system in place, protection of foreigners’ intellectual property rights was particularly poor. For example, despite being a strong defender of an international patent system, the US still did not recognise

foreigners' copyrights, and many German firms were still busy producing counterfeit English goods.

Generalised limited liability existed only in a few countries (it was first introduced in Sweden in 1848 and in Britain in 1856), and even these countries did not have regulations regarding auditing and information disclosure of limited liability companies. It had been barely 3 decades since the UK established a relatively modern bankruptcy law (1849), and the USA still did not have a federal bankruptcy law. Competition laws were still non-existent, despite the rapid rise of large firms and trust activities (by this time, the Article 419 of the French Penal Code of 1810 fell into disuse).

Banks were still new institutions in many NDCs, and many of these countries still did not have a central bank (e.g., Italy, Switzerland, and the USA). Even in countries which nominally had a central bank, their effectiveness was highly limited because they did not have monopoly over note issue (e.g., Sweden, Germany). Banking regulation was still a rarity, with widespread "cronyistic" lending and resulting bank failures. Even the UK, the country with the most developed securities market, did not have a proper securities regulation. As a result, insider trading and price manipulation abounded in securities markets. A permanent income tax, which was introduced first in Britain in 1842, was still a novelty.

None of the countries had modern social welfare schemes, the only exception being the industrial accident insurance introduced in Germany in 1871. Institutions regulating child labour now existed in a number of countries (e.g., the UK, Germany, Sweden), but were often very poorly enforced. In any case, they still allowed employment of relatively young children (those above between 9 and 12, depending on the country). Other countries had no regulation on child labour whatsoever at this time (e.g., the US, Italy, Norway). There was still no restriction on adult male working hours in any of the NDCs, although some countries now had restriction on female working hours (but even then set at the relatively high 10-12 hours). Workplace safety laws, if they existed, were virtually un-enforced.

3.3. 1913 – The Beginning of Industrial Maturity

Even as late as 1913, when the richest of the NDCs reached the level of the richer developing countries of today (say, Brazil, Thailand, Turkey, Mexico, Colombia), from whom these days "world standard" institutions are expected, the NDCs had low quality institutions by such standards.

Universal suffrage was still a novelty (Norway and New Zealand), and even a genuine male universal suffrage in the sense of "one adult man one vote" was not a common institution. For example, the USA and Australia had racial qualifications, and the Germans had different number of votes according to property, education, and age. Secret ballots were just introduced in France (1913) and Germany still did not have them. Bureaucratic modernisation has progressed quite a lot, especially in Germany, but spoils system was still widespread in many countries (e.g., USA, Spain) and bureaucratic professionalism was only just emerging even in countries like the US (it had barely been three decades since even a minimal degree of competitive recruitment was introduced in the US federal bureaucracy in 1883).

Even in the UK and the USA, corporate governance institutions fell miserably short of modern standards. For example, the UK introduced compulsory auditing for limited liability companies barely a decade ago (1900), but due to a loophole in legislation, companies did not have to provide up-to-date balance sheets. Both in the UK and the USA, full disclosure to investors on public stock offering was still not compulsory. Competition law was non-existent except in the USA (the Sherman Act, 1890), but even the USA had wait for the 1914 Clayton

Act to have an antitrust law worth its name. Europe had to wait for another decade before it got the first competition law (the 1923 cartel law in Germany).

Banking was still underdeveloped, with branch banking still not allowed in the USA. Banking regulation was still patchy in most countries. Central bank was becoming a common institution, but it was still far from what we expect these days. For example, in the US, central banking was barely born (1913) and covered only 30% of the banks in the country. The Italian central bank was still fighting for monopoly over note issue. Insider trading and stock price manipulation was still not properly regulated. Neither the UK nor the US, the two countries with the then most-developed securities markets, did not have a securities regulation (they had to wait until 1939 and 1933 respectively). Income tax was still a novelty. For example, the US introduced it only in 1913 after two decades of political fights and legal wrangling, and Sweden, despite its extensive use of it in subsequent periods, did not have an income tax yet.

The only area where the NDCs did rather well compared to the currently developing countries at comparable levels of development is social welfare institutions, which had seen quite impressive developments since the 1880s. By 1913, all NDCs outside North America (i.e., Canada and the USA) had (sometimes highly incomplete) industrial accident insurance, health insurance (except the Netherlands, Finland, and Australia), and state pension (except Norway, Finland, and Switzerland), although unemployment insurance was still a novelty (first introduced in France in 1905, and introduced in Ireland, UK, Denmark, and Norway by 1913). However, some countries still disenfranchised the recipients of social welfare at this time (e.g., Norway, Sweden).

Many labour legislations regarding working hours, workplace safety, female labour, and child labour were introduced by this time, but the standards were rather low, the coverage limited, and enforcement poor. For example, in the US, even a 10-hour working day was fiercely resisted by the employers and conservative judges, and it would be another quarter century before child labour was banned at the federal level (1938). No country attained even a 48-hour workweek (not to mention the 40-hour week) until this time.

3.4. Understanding Institutional Development

3.4.1. How Institutionally Developed Were the NDCs in Earlier Times?

The first thing that becomes immediately obvious from our preceding discussion is that the NDCs were institutionally *less* advanced compared to the currently developing countries at similar stages of development.

In table 5, we compare the per capita incomes of the now-developed countries during the 19th century and the early 20th century (in 1990 international dollars) with those of the developing countries of today (1992, to be more precise). Obviously, this comparison is only a very rough-and-ready one, as there are well-known problems with using income figures to measure a country's level of development, especially when it involves historical statistics. However, our exercise gives us some rough idea as to where the NDCs were in terms of institutional development when they were developing.

The comparison shows that, in the 1820s, most of the NDCs were, roughly speaking, at the level of development between Bangladesh (\$720 per capita income) and Egypt (\$1,927 per capita income) of today – a grouping that includes countries like Burma (Myanmar), Ghana, Cote d'Ivoire, Kenya, Nigeria, India, and Pakistan. By 1875, most of them have moved beyond the Nigeria-India level of income, but even the richest ones (the UK, New Zealand, Australia) were at the level of today's China (\$3,098) or Peru (\$3,232), and the rest of them (including the USA, Germany, and France) at the level between Pakistan (\$1,642) and Indonesia (\$2,749). By 1913, the richest of the NDCs (the UK, the USA, Australia, and New Zealand) reached the level of the richer developing countries of today (e.g., Brazil, Mexico, Colombia, Thailand), but still the majority of them

(from Finland to France and Austria) were at the level of middle-income developing countries of today (the Philippines, Morocco, Indonesia, China, and Peru).

When we match these income comparisons with the 3 historical snapshots of the NDCs that we provided above (sections 3.1 – 3.3), we immediately realise that the NDCs in earlier times had relatively low levels of institutional development compared to the developing countries of today that are at comparable levels of development.

For example, in 1820, the UK was at a somewhat higher level of development than that of India today, but it did not even have many of the most “basic” institutions that India has – universal suffrage (it did not even have universal *male* suffrage), a central bank, income tax, generalised limited liability, a generalised bankruptcy law, a professional bureaucracy, meaningful securities regulations, and even minimal labour regulations (except for a couple of minimal and hardly-enforced regulations on child labour).

For another example, in 1875, Italy was at a level of development comparable to that of Pakistan’s today, but did not have universal male suffrage, a professional bureaucracy, an even a remotely independent and professional judiciary, a central bank with note issue monopoly, and competition law – institutions that Pakistan has had for decades (except for periodic disruptions in democracy due to military intervention, but even then suffrage, when allowed, has remained universal).

For still another example, in 1913, the US was at a level of development similar to that of Mexico today. However, its level of institutional development was well behind that we see in Mexico today. Women were still formally disenfranchised and blacks and other ethnic minorities were *de facto* disenfranchised in many parts of the country. It had been just over a decade since a federal bankruptcy law was legislated (1898) and it had been barely two decades since the country recognised foreigner’s copyrights (1891). A (highly incomplete) central banking system and income tax literally only just came into being (1913), and the establishment of a meaningful competition law (the Clayton Act) had to wait another year (1914). Also, there was no regulation on securities trading or on child labour, with what few state legislations that existed in these areas being of low quality and very poorly enforced.

These comparisons can go on, but the point is that in the early days of their economic development, the NDCs were operating with much less developed institutional structures than what exist in today’s developing countries at comparable levels of development, not to speak of the even higher “global standards” that the latter countries are forced to conform to these days.

Table 5. Where were the Now-Developed Countries when they were developing?
(1990 dollars)

Per Capita Income Band (dollars)	Now-Developed Countries (1750)	Now-Developed Countries (1820)	Now-Developed Countries (1875)	Now-Developed Countries (1913)	Developing Countries (1992)
Below 1,000	France (921)	Japan (704) Finland (759) Canada (893) Ireland (954)			Ethiopia (300) Bangladesh (720) Burma (748)
1,000-1,500	UK (1,328)	Norway (1,002) Spain (1,063) Italy (1,092) Germany (1,112) Sweden (1,198) France (1,218) Denmark (1,225) USA (1,287) Belgium (1,291) Austria (1,295)	Finland (1,176) Norway (1,469)	Japan (1,334) Portugal (1,354)	Ghana (1,007) Kenya (1,055) Cote d'Ivoire (1,134) Nigeria (1,152) India (1,348)
1,500-2,000		Australia (1,528) Netherlands (1,561) UK (1,756)	Italy (1,516) Canada (1,690) Sweden (1,835) Austria (1,986)	Greece (1,621)	Pakistan (1,642) Egypt (1,927)
2,000-3,000			Denmark (2,031) France (2,198) Germany (2,198) USA (2,599) Belgium (2,800) Netherlands (2,829)	Finland (2,050) Spain (2,255) Norway (2,275) Italy (2,507) Ireland (2,733)	Philippines (2,213) Morocco (2,327) Indonesia (2,749)

3,000-4,000			New Zealand (3,707) UK (3,511)	Sweden (3,096) France (3,452) Austria (3,488) Denmark (3,764) Germany (3,833) Netherlands (3,950)	Peru (3,232) China (3,098)
4,000-5,000			Australia (4,433)	Belgium (4,130) Switzerland (4,207) Canada (4,231)	Turkey (4,422) Thailand (4,422) Brazil (4,862)
5,000-6,000				UK (5,032) New Zealand (5,178) USA (5,307) Australia (5,505)	Mexico (5,098) Colombia (5,359)

Source: Maddison (1995). The 1750 figures are extrapolated from 1820 data, with annual growth rate taken as 0.4% for both the UK and France. 0.4% is the weighted average of estimates by economic historians of England (de Vries, 1984). It is widely accepted among economic historians that the French growth rate of the time was similar to that of England (Crouzet, 1967).

3.4.2. How Important Were (and Are) “Good Institutions” for Growth?

The discussion in the preceding section (3.4.1) shows how in the earlier days of their development the NDCs were operating without most of institutions that we expect even from the poorest developing economies of our time. However, despite this, the NDCs were still growing much faster than what has recently been the norm among the developing countries (except for a handful of “miracle” economies).

As we can see from table 6, per capita income growth rate among the 11 NDCs for which data are available during this period ranged between 0.6% (Italy) and 2% (Australia), with the unweighted average and the median values both at 1.1%. Table 6 also shows that between 1875 and 1913, when the quality of institutions in the NDCs still substantially fell short of that in today's developing countries at comparable levels of economic development, per capita income growth rates ranged between 0.6% (Australia) and 2.4% (Canada), with the unweighted average at 1.7% and the median at 1.4%.

Table 6. Per capita Growth Performance among the NDCs in Earlier Times

	1820-1875 (%)	1875-1913 (%)
Australia	2.0	0.6
Austria	0.8	1.5
Belgium	1.4	1.0
Canada	1.2	2.4
Denmark	0.9	1.6
Finland	0.8	1.5
France	1.1	1.2
Germany	1.2	1.5
Italy	0.6	1.3
Netherlands	1.1	0.9
Norway	0.7	1.2
Sweden	0.8	1.4
UK	1.3	1.0
USA	1.3	1.9
Unweighted Average	1.1	1.7
Median	1.1	1.4

Source: Calculated from Maddison (1995)

In contrast, the developing countries of our time, despite having higher-quality institutions and having recently had them “improved” even more through various programmes of “structural adjustment”, “transition” and “governance reform”, have found it difficult to grow at all.

Table 7 shows the indicators of per capita income growth in the developing countries over the last 15 years, which we name the “age of institutional reform”. It shows that, once we exclude China and India, both of which interestingly get frequent lambasting for their poor “governance” quality by the IFIs, during this period the 47 low-income countries (according to the World Bank classification, see note 1 to table 7 for further details) have experienced near stagnation in their per capita income and the 41 lower-middle-income countries (see note 1 to table 7) have experienced a serious fall in their per capita income. Given that most developing countries suffered a slowdown in growth over the last couple of years following the financial turmoil sparked off by the Asian financial crises, their records for the 1990s as a whole is likely to be even less impressive than what we see in the table.

Table 7. Per capita Growth Performance in Developing Countries during the “Age of Institutional Reform”

	1985-95 GNP growth rate per capita (%) ¹	1990-98 GDP growth rate per capita (%) ²
Low-income countries	3.8	5.3
Minus China and India	-1.4	1.0
Middle-income countries	-0.7	0.4
Lower-middle-income	-1.3	-2.7
Upper-middle-income	0.2	2.3

¹The data is from *World Development Report, 1997*, Selected World Development Indicators, Table 1 (Basic Indicators). See the original source table for country classification. But in terms of the countries cited in our table 5, the low-income group will include the countries up to Pakistan, the upper-middle group will include Mexico and Brazil, and the rest will belong to the lower-middle group.

²The data is from *World Development Report, 2000*, complemented by the data from the web version of the data set posted in the World Bank website. The figures are only approximate, as they were constructed by subtracting the population growth rates from GDP growth rates. This had to be done because the World Bank stopped publishing decade-wise per capita GNP growth rates from its 1998 *World Development Report*. Country classification is not provided in the source tables in the 2000 *Report*, and therefore it is assumed that the same classification as that used in 1997 was applied.

This is only a very rough comparison, but the picture seems to be clear. When they were developing countries themselves, the NDCs did clearly better than the currently developing countries have done for the last 15 years or so, despite the fact that they had much worse institutions. Especially when considering that the last 15 years or so has been the “age of institutional reform” in the developing countries when the quality of their institutions is supposed to have improved, this comparison makes us wonder how much of the current “development failures” can we attribute to “bad institutions”, at least in the forms that are currently identified.²⁷

This, in turn, raises the important issue of causality in the “good governance” discourse. The underlying assumption in this discourse is that the causality runs from institutions to development and therefore that good institutions have to be put in place before economic development starts. However, our discussion shows that good institutions came *after rather than before* growth in the NDCs, suggesting that the causality is probably the reverse, although it is also important to emphasise that there can be feedback mechanisms running from institutions to growth.²⁸ Of course, this does not rule

²⁷ It may also be noted that the developing countries themselves were doing much better during the “bad old days” of the 1960s than they are doing now – according to Rodrik’s calculation, the average per capita growth rate for the developing countries during 1960-73 was a thumping 2.52% (and the median rate 2.59%) (Rodrik, 1999a, p. 75, table 4.3).

²⁸ Here we are reminded of the remark made in 1770 by the German economist-mathematician-physicist-poet Johann Jacob Meyen, who is now almost completely forgotten. Meyen remarked that “it is known that a primitive people does not improve their customs and habits later to find useful industries but the other way around” (as cited and translated by Reinert, 2000; the original source is *Wie kommt es, dass de*

out the possibility that the NDCs would have done even better if they had better institutions in place at the time, but it seems difficult not to draw the conclusion that many institutions are endogenous, rather than exogenous, variables in the developmental process.

Thus seen, we should be careful in accepting the conclusion of the “good governance” discourse, which believes that whatever institutions that exist in the NDCs *now* are going to be good for the developing countries too. What is more useful will be to identify the institutions that enabled the NDCs develop in the absence of the institutions that the “good governance” discourse think are necessary for development. Carefully identifying the institutions that are “really necessary” for countries in the early stages of development is crucial not least because institutions are expensive to set up and run. Given the severe financial and human resources constraints that they face, developing countries should not be made to waste their resources in establishing and running “non-essential” institutions.

3.4.3. How Long Did It Take the NDCs to Develop Their Institutions?

The third point that emerges from our discussion is that it took the NDCs decades, if not centuries, to develop institutions from the time when the need for them had been perceived. It should be also pointed out that the NDCs frequently experienced reversals in this process. Let us provide some examples to illustrate this point.

Democracy took long time to develop. Just to give a couple of examples, it took France and Switzerland almost 100 years (1848 to 1946 and 1879 to 1971, respectively) to move from universal male suffrage to universal suffrage. The need for modern professional bureaucracy was widely perceived at least from the 18th century, but it was only in the late 19th century that such bureaucracy was instituted many NDCs. The value of limited liability institutions was already recognised in the 16th century, when royal charters permitting limited liability was granted to big ventures, but it was not generalised until the mid-19th century even in the most advanced countries. The need for central banking was widely perceived from at least the 17th century, but the first “real” central bank, the Bank of England, was instituted only in 1844. The US felt the need for at least some degree of central banking from the very early days of its existence, as can be seen in the establishment of the (short-lived) First Bank of the USA in 1791, but it was only in 1913 that the Federal Reserve System was put in its place (even then its coverage was still highly limited). And so on.

The diffusion of new institutions from the “innovator” country to the rest of the NDCs also took considerable time. The Appendix Table charts, whenever possible (which is not very often, unfortunately), where and when different institution emerged first, when they got adopted by the majority of the NDCs, and when they got accepted by all the NDCs. The table shows that, even when we exclude the exceptional case of the “pre-modern” patent law, it took anything between 20 years (e.g., state pension, unemployment insurance) and one-and-half centuries (e.g., modern central banking) between an institutional innovation and its adoption by the majority of the NDCs. The table also shows that when it comes to the time period between an institutional innovation and its adoption as an “international standard” among the NDCs (i.e., all or nearly all of them adopting it), we are talking in units of generation, and not even decade. The reasons behind this slow pace of institutional development in the NDCs were diverse.

Oekonomie bischer so wenig Vortheile von der Physik und Mathematik gewonnen hat? [Why has economics so far gained so few advantages from physics and mathematics?], Berlin, Haude & Spener, 1770). I thank Erik Reinert for drawing my attention to this quote.

First of all, especially in the earlier stages of development, many institutions did not get adopted or remained ineffective (when adopted) because they were “unaffordable”. The absence of social welfare and labour regulations are the more obvious examples in this regard, but also many institutions of corporate governance and finance remained ineffective in their earlier times because there were not enough resources for their enforcement.

Second, in many cases institutions did not get accepted, even when they had become “affordable”, because of the resistance from those who will (at least in the short run) lose out from the introduction of such institutions. Resistance to democracy, labour regulation, or income tax are probably the best examples in this regard.

Third, sometimes institutions did not get adopted because the economic logic behind them was not properly understood by the contemporaries. The resistance to limited liability or central banking even by many of those who would have benefited from such institutions are good examples of this.

Fourth, there were also institutions that did not get adopted because of “epochal prejudices” even when they had become obviously “affordable” and the logic behind them understood. The late introduction of professional bureaucracy in the US due to the Jacksonian prejudice against professionalism or the late introduction of female suffrage in Switzerland are probably the best examples in this regard.

Fifth, institutional development sometimes got delayed because of the interdependence between certain institutions, which required simultaneous developments of related institutions. For example, without the development of public finance institutions to collect taxes, it was difficult to properly pay for a modern professional bureaucracy, but without a developed tax bureaucracy, it was difficult to develop public finance institutions. It is no coincidence that the development of modern bureaucracy went hand in hand with the development of the fiscal capacity of the state.

More detailed historical knowledge will be required in order to explain why a particular institution did not get adopted in a particular country at a particular time, and this is no place to engage in such discussion. However, what seems clear from our discussion is that institutions typically take decades, if not generations, to develop. Thus seen, the currently popular demand that developing countries should adopt “world standard” institutions right away, or at least in the next 5-10 years, or face punishments seems to be at odds with the historical experiences of the NDCs.

4. Implications

Our discussion so far makes us conclude that the current push for “good governance” by some donor governments and the IFIs is highly problematic in a number of ways. We believe that the following points have to be taken into account before the donor governments and the IFIs push this agenda even further.

First of all, we need to be careful in deciding which of the institutions promoted by the “good governance” discourse are really necessary for which developing countries. Our discussion suggests that many of the institutions that are currently being promoted as being “necessary” for development emerged after, and not before, economic development in the NDCs. Of course, this does not allow us to rule out the possibility that, even if not “necessary”, these institutions could still be “good” for the developing countries. However, given that institutions are costly to establish and run, demanding the developing countries to adopt institutions that are not strictly necessary has serious opportunity cost implications. For example, if the developing countries need to train a large army of world-class lawyers or accountants in order to have “global standard”

property rights and corporate governance institutions, which after all may not be very necessary at their stages of development, they will inevitably have less money (their own or the donors') to spend on training schoolteachers or industrial engineers, who may be more necessary given their stages of development.²⁹

Second, our discussion suggests that, even when we agree that certain institutions are "necessary" even for developing countries, we have to be careful in specifying their exact shapes. So, for example, we may agree that a "good" property rights regime is necessary for exchanges and investments to happen even in early stages of development, but this regime cannot be equated with a regime providing strong protection of whatever property rights that exist (see section 2.3.1). For another example, we may all agree that a "good bureaucracy" is necessary for development, but it is debatable whether it means the traditional Weberian bureaucracy or the more "open" and "individualistic" one that the "new public management" theory recommends, which is in fact quite similar to the early bureaucracies in the NDCs (e.g., absence of well-defined career paths, fee-based compensation).

Third, regardless of the exact kinds and quality of institutions that we want from developing countries, we should accept that institutional development takes a long time and be more "patient" with the process. Our paper shows that it took the NDCs decades, if not centuries, to develop institution from the time when the need for them had been perceived, and that there were frequent setbacks and reversals in the process. Seen from this perspective, the 5-10 years' transition periods currently given to the developing countries to bring their institutional standards up to the "global standard" are highly inadequate. This, of course, should not necessarily mean adopting standards of the last century nor should it make us accept whatever "we-are-not-ready-yet" argument that is put forward by developing country governments (more on this point later). However, it is clear that there should be a keener recognition of the limit to the speed with which institutional development can be achieved.

Fourth, given that the developing countries of today are already institutionally more advanced than the NDCs at comparable levels of development, asking these countries to install a range of new "global standard" institutions and radically improve the quality of their existing institutions seems unrealistic. It could even be argued that in demanding from developing countries standards that they themselves never had achieved at comparable levels of development, the NDCs are effectively adopting double standards or even trying to hurt the developing countries by imposing "expensive" and often "unnecessary" institutions on them that they neither need nor can afford. Of course, it may be that those in the NDCs who are making such demands are doing so only because they do not know their own history (and in that sense neither hypocritical nor sinister), but that is not a good defense. The NDCs need to learn more about their own history and have more humility and sensitivity in their approach to this issue.

Thus seen, in pushing for the "good governance" agenda, the donor governments and the IFIs need to be more careful in identifying which institutions are "necessary" for which developing countries, be more aware of the costs involved in setting up and running such institutions (especially when they may not be so "necessary"), be more realistic about the possible speed of institutional development in these countries, and have more humility and be more sensitive to the issue of historical justice given their own historical records.

²⁹ An anecdote that supports our point here is that, right after the collapse of socialism in Mongolia, the US government provided a large sum of money to Harvard University to train dozens of bright young Mongolians as stockbrokers – money that could be used for a lot of other useful "developmental" purposes.

At least two objections can be raised against the above observations. First of all, one could argue that the “world standard” in institutions has risen over the last century or so, and therefore that the current developing countries should not consider the NDCs of 100, 150 years ago as their models. The second objection is that the developing countries should adopt the “best practice” institutions even if some of them may not be directly beneficial for them, because otherwise they will be shunned by international investors and suffer as a result.

In relation to the first point, I must say that I wholeheartedly agree with it. Indeed, it will be absurd to argue for that. India may be at a similar level of development to that of the US in 1820, but that should not mean that it will have to re-introduce slavery, abolish universal suffrage, de-professionalise its bureaucracy, abolish generalised limited liability, abolish the central bank, abolish income tax, abolish competition law, and so on.

Indeed the heightened global standard in institutions has been a good thing in many ways for the developing countries, or at least the reformers in them. Unlike their counterparts in the NDCs of yesterday, the reformers in the developing countries don't have to struggle (at least too hard) with the view that things like female suffrage, income tax, restrictions on working hours, and social welfare spell the end of the civilisation as we know it. They also don't have to re-invent certain institutions like central banking and limited liability, the logic behind which many people the NDCs in earlier times found difficult to understand. Indeed, the developing countries should exploit this advantage of being late-comers to the maximum and try to achieve the highest level of institutional development possible.

What we are wary about, however, is the view that institutions are simply matter of choice and therefore all countries should try to reach the (quite highly-set) “minimum global standard” right away or within minimal “transition” periods. While accepting that late-comer countries do not have to spend as much time as the pioneer countries in developing new institutions, we should not forget that it took the NDCs typically decades, if not centuries, in establishing certain institution whose need had been perceived. And it usually took them another few decades to make them work properly.

I have more problems with the second point, namely, that countries that do not keep up with global institutional standards will be disadvantaged because international investors will shun them.

First of all, it is not clear whether international investors do necessarily care so much about the institutions promoted by those who believe in the “good governance” agenda. For example, countries like China have been able to attract huge amount of foreign investments despite the absence of a “good governance” regime as currently defined, suggesting that what the investors really want is often different from what they say they want or what the IFIs say they want - democracy and the rule of law being the best examples in this regard. Surveys among foreign investors suggest that most “governance” variables are much less important than factors like market size and growth in determining their investments. This suggests that the relationship between the governance structure and foreign investments is a lot more complicated than what is assumed by the proponents of the “good governance” agenda.

Second, while increased conformity to international standards in institutions may bring about increased foreign investments, foreign investments are not going to be the key element in most countries' growth mechanisms. In other words, the potential value of an institution to a country should be determined more by what it will do to promote internal development rather than by what the international investors will think about them. As I argued earlier, many of the institutions that are currently promoted by the proponents of the “good governance” framework are not necessary for development. Some of them

may not even be good for development at all (e.g., certain property rights). Especially when considering their set-up and maintenance costs, establishing such institutions can easily net negative overall impacts, even if this leads to higher foreign investments.

Third, even if certain “good” institutions get introduced under global pressure, they may not deliver the expected results, unless they can be effectively enforced. While we may welcome certain degree of external pressures in situations where a developing country is resisting the introduction of certain institutions that are obviously “affordable” (and are compatible with the prevailing political and cultural norms in the society), we should also recognise that the introduction of institutions in countries that are not “ready” creates all kinds of problems. Examples include democracies undermined by military coups, electoral frauds, and vote buying, or income taxes routinely and openly evaded by the rich in the developing countries. There will be also problems with institutional changes that are imposed from outside without “local ownership”, as the current jargon has it. If that is the case, cleverer international investors will figure out that having certain institutions on paper is not the same as really having it, which means that introducing such institutions will make little difference to the country’s attractiveness to foreign investors.

Fourth, as far as the donor governments and the IFIs are able to influence the way in which the “global standard” is defined, interpreted, and promoted, there is still a value in discussing what institutions should be asked of which developing countries. The “follow the global norm or perish” argument assumes that the process of institutional evolution is beyond anyone’s control, but this is obviously false. The donor governments (at least the major ones) and the IFIs are not weathervanes blindly following the winds of international investor sentiments, but they can, and do, actively decide to a large extent which institutions they push for how strongly.

The present paper has tried to show that the currently dominant agenda for “governance reform” and “institutional development” needs a serious re-examination. The historical experiences of the now-developed countries show how some institutions that we take for granted (even for the developing countries of today) are products of lengthy processes of institutional development involving political struggles, ideological battles, and legal reforms. While some degree of institutional copying is possible and desirable, institutions are often not things that can be easily copied by every country regardless of their conditions, and therefore recommendations for institutional development have to be made with great caution.

Unless there is a complete change of perspective among the proponents of the “good governance” agenda in its present form, the push for “global standards” will at best remain highly ineffective in addressing the development failure of many developing countries and at worst be harmful for their development – and indeed harmful for the developed countries themselves, given that the continued developmental failure in the developing countries will reduce the demand for their exports, increase illegal immigrants, and intensify international economic instability.

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