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WHY MIGHT HISTORY MATTER FOR DEVELOPMENT POLICY?

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Listen Up Economists,
Why Might History Matter for Development Policy?
(Hint: It's All in the Mind)

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When we economists analyze development policy, what do we do? First of all, we have to have a description of the economy—of individuals, households, firms, farms and any other relevant entities, how they behave and how they interact. Typically, we model this interaction as being through markets, mostly competitive, although every now and then (for example for oligopolistic product markets) we do model non-competitive interactions, and (for example for interactions within the household) we do model non-market interactions. Having set up the "non-policy" outcome (that is to say, non the policy we are interested in) we then introduce the policy and work out the consequences given our model of the economy specified earlier. For those of us in the new political economy school, we might also try to endogenize the policy choice itself, by in turn modeling the policy and political process, the incentives of the different players (interest groups). In this setting, the consequences of introducing a policy might be very different, since over and above how individuals, households etc react to the policy is how the policy gets implemented, and

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[1] Cornell University: T.H. Lee Professor of World Affairs, International Professor of Applied Economics and Management, and Professor of Economics. This note was prepared in response to the Workshop on History and Development Policy, held at the University of Manchester on April 7-8, 2008. I was a discussant on two papers: "Welfare Citizenship, Rural Poverty and Epidemiological Patterning: Extending the Solar case for the Relative Efficacy of Poor Relief Provisions Under the English Old Poor Law," by Richard Smith; and "Social Spending in Contemporary China: Historical Priorities and Contemporary Possibilities," by R. Bin Wong. This note is inspired by these papers, and the other papers and discussion at the conference.

perhaps how other policies in turn get changed, or get influenced to be changed, by interest groups whose behavior we hope to have modeled sufficiently accurately.

So far so good, or so controversial, because encapsulated in the above are the divisions that dog economic analysis of development policy, even when all sides agree on the objective of development policy (for example, reducing infant mortality rates, rather than building a sense of and a pride in nationhood). Depending on assumptions of how markets behave, or how the political economy behaves, very different conclusions can be reached, for example, about the policy of reducing tariffs. If markets are competitive, and the political economy is impotent, then reducing tariffs turns out to improve the general welfare, suitably defined, despite some distributional consequences. But political economy is not of course impotent, otherwise the repeal of the Corn Laws in the 19th century Britain would not have been such a prolonged affair, and the Economist magazine would not have had to be founded to argue the case for it, and Trollope would not have had such great material for his novels. And markets are not necessarily perfectly competitive, or else Adam Smith would not have had to observe that "People of the same trade seldom meet together even for merriment and diversion, but the conversation ends in a conspiracy against the public or some contrivance to raise prices."

We economists know all this, of course. We get a bad rap from the other social scientists for ignoring distribution and politics. We certainly don't ignore these things at the research frontier, but we often ignore it at the policy coal face. Paradoxically, therefore, where it matters most we tend to ignore politics in the policy prescription, although these days our research papers are replete with models of rational choice politics.

There are two other features of the models and the world view, which underpin our policy analysis, that are worth highlighting. We take “initial conditions” of natural resources, technology, etc as given for the policy analysis. And we take the behavioral responses of the different entities in our models not only as given but also to follow particular precepts and patterns. Rational choice—utility maximizing for individuals, profit maximizing for firms—is what drives our agents and hence our models. Again we are aware of this. We know that initial physical conditions matter—that is why economies rich in natural resources perform differently to those rich in unskilled labor (perhaps “poor in” might be a better description). In some sense the market structure—which markets are competitive, which are not--is also part of the initial conditions.

So the outcome of a policy intervention depends on a lot of things. But how does it depend on history? Well, in a very straightforward sense today’s physical initial conditions are the result of history. Natural resource deposits are of course the product of prehistory. But this is perhaps not an interesting sense in which history matters. They are also the product of extraction in the past, which did depend on human behavior and thus begins to be an interesting sense in which history matters for development policy—human history altered the then initial conditions to give us the initial conditions of now, and since these initial conditions matter for the outcome of development policy, history matters for development policy. But does the simple time line of natural resource deposits, leading up to their current level, matter above and beyond what the current level is? Only if that time trend revealed something about the structure of the economy, how its entities would have had to have interacted to have led to that pattern and if that interaction were to continue, then history would be illuminating. But again, this is nothing new to economists. Torturing

historical time series data to reveal an underlying structure (or rather, to confess to a substructure within an assumed overall frame, the “maintained hypothesis”) is what econometricians do all the time. So what exactly is it that history gets us afresh?

I would like to suggest that what it gets us is a handle on how the agents in the economy—individuals, households, firms, interest groups, etc--will respond to the policy intervention in question, taking as given the physical initial conditions (natural resources, technology, market structure, etc). But in order to allow the seed of this suggestion to take root it cannot be allowed to fall on the stony ground of conventional rational choice theory. Some people give up their lives for a cause. Others will suffer great hardship, undergo starvation, rather than eat food that is not acceptable to them culturally. Generally, human beings seem to be more than willing to cut off their noses to spite their faces or, to put it more generously, inflict great losses upon themselves and upon others to right what they consider to be an unjust outcome. They will leave money on the table if they perceive that picking it up would be unfair. There is considerable evidence of this in recorded human experience, from Homer and Herodotus, from Holinshed and Shakespeare, from Schicklgruber and Trevor-Roper. But, if it was needed, recent lab experiments with (mainly) American college students have begun to convince economists that there may be something in these deviations from rational choice theory after all.

Once we economists accept this departure from rational choice theory, then the actual preferences and behavioral tendencies of individuals and groups within society become part of the initial conditions of our model, the model through which we are going to assess the proposed policy intervention. But how *these* initial conditions came to be is more interesting, or at least less mechanical, than physical initial conditions such as natural

resource availability, or even market structure. The same policy intervention, for example means testing of social benefits, elicits very different individual and social responses in different societies, for example Europe and America—and even within Europe there are variations. There is a visceral reaction to inflation in Germany which is very different from that elsewhere in Europe. And progressive taxation, and redistributive policies more generally, gets very different responses in different countries.

These examples hint strongly that it is the history of the different societies that explains the difference. But this is just correlation? What is the causal mechanism? Scratching beneath the surface reveals that simple arguments will not suffice. Take the case of German inflation. For the immediate post war generation in Germany, hyperinflation was a living memory. It is understandable that they would be willing to incur significant costs in other dimensions to control inflation. For the generation that followed, the hyperinflation was their parents' inflation, they had not themselves experienced it. But their concern is perhaps explainable by inculcation through parents. But what about the current generation, whose defining event was not the putting up of the Berlin wall, but its fall. Anti-inflation sentiment in Germany remains high, eighty years, four generations, after Weimar; sixty years after the Second World War; forty years after the Berlin wall went up; and now almost twenty years after it came down. The policy failures of four generations ago continue to animate attitudes to policy today, and underpin the stance of the Bundesbank and through it the stance of the European Central Bank.

Clearly, history matters, and it matters in important and interesting ways for policy today. But it is not just actual events in the past. It is how they are recorded, interpreted, and the interpretation transmitted, that matters. This is what determines the mental makeup,

the preferences in economists' terminology, of agents in the economy. That is the causal mechanism. It is the embedding of the past in the present's perception of policy that is the transmission mechanism linking history to today's development policy. That it is perception, and not reality (whatever that is or was), does not matter. For purposes of the analysis of development policy, how agents in the economy will react to it, perception *is* reality. If means testing is detested because in the past means test officers terrorized poor communities and heaped indignities upon them, and indeed this in turn was the outcome of a long history of a fear that poor relief would make poverty too easy[2], and this has now become folk memory through a seamless combination of word of mouth, literature and, more recently, television, then that is the reality that policy will have to deal with. The balance may have to be shifted towards more Universalist approaches to benefit provision, with consequent loss in efficiency of resource use. But that is how it has to be—history matters.

History matters also to how a ruling elite perceives its objectives and its constraints. The strong concern about inequality, especially spatial inequality, in China goes back to well before the communist era. It is rooted in the history of an empire with fissiparous tendencies, requiring force and suasion in equal measure to keep provinces from breaking away. It is that concern which is reflected in generations of Chinese rulers, right up to the present ruling elite of the Communist party. But, again, what is the transmission mechanism from the sensibilities acquired by the rules of the Qing Empire in the 18th century to the rulers of the Communist party today. It is not just, of course, the raw facts of what happened in the 18th century, the investment in flood control, famine relief,

[2] The attitudes and debates in Tudor England are discussed in "Welfare Citizenship, Rural Poverty and Epidemiological Patterning: Extending the Solar case for the Relative Efficacy of Poor Relief Provisions Under the English Old Poor Law," by Richard Smith.

orphanages and so on, but how these have been woven together through successive interpretations into a coherent narrative that has symbolic meaning to today's rulers.[3] And it is no less real for being symbolic. It affects today's policy stance. History matters.

It should be clear, then, that the way in which history matters is more than as a series of facts and events in the past related to the policy in question, say. Rather, what is equally if not more important is how and in what form these events of the past came to be embedded in the consciousness of the present generation. Indeed, as noted above, what is in the present consciousness may be quite far removed from the reality of the past, but it is the reality of the present, and thus influences the response to policy of individuals and groups of individuals.

None of this is to suggest that history is destiny. Policy makers do not have to be the prisoners of the past, at least the past as it is embedded in the perceptions of the present generation. But they cannot ignore it either. At the very least they have to know what these perceptions are—this is just prudent description of the reality onto which the policy intervention will be implemented. But they must go further. If they are to overcome the weight of the past, they have to understand why the population and the polity have these perceptions about this or that policy. What was the process that led to their embedding—what events in the past, what sort of interpretation, what transmission mechanism. It is only with this knowledge, knowledge that only the disciplined study of history in its various facets (political, social, intellectual, cultural) can provide, that they can address the constraints, or the opportunities, that history presents to them for the policy question at

[3] I interpret this to be one of the main points of "Social Spending in Contemporary China: Historical Priorities and Contemporary Possibilities," by R. Bin Wong.

hand. This is finally, in my view, the most important sense in which history matters for development policy. Listen up, economists!

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