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Introduction: Factor markets in global economic history

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1. INTRODUCTION

Markets for labour, land and capital play important roles in the long-term evolution of economies. In the course of recent centuries, the exchange of land, labour and capital by way of the market – whereby prices are mainly determined by supply and demand – has become ever more important. These exchanges increasingly replaced other systems of exchange and allocation, such as those by way of tribute, voluntary redistribution or systems applying some type of coercion, as in the manorial system. This rise of what are termed ‘factor markets’, occurring most conspicuously in Western Europe, has had profound effects on economic development. Most economic historians – whether from neo-classical, neo-institutionalist or neo-Marxist schools – would agree that mobility of factors of production, specialization and technological change are often linked with, or promoted by, the rise of wage labour, land leases and large-scale loans and investments, and the concomitant market competition. The growth of factor markets is not a unilinear process, however, but one fraught with stagnation, crises and even the reversal of trends. Moreover, the process displays striking regional differences. While, for example, the commercial heartland of Europe witnessed the rise of large, flexible factor markets as early as the late medieval and early modern

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periods, other parts of Europe experienced these only in the nineteenth century. In the twentieth century similar differences persisted on a global scale. Parts of the globe – Southeast Asia, for example – were caught in a development path characterized by high interest rates, high indebtedness and low rates of savings, a situation from which these economies were unable to escape (see the article by Peter Boomgaard in this issue). Western Europe, on the other hand, did not witness a similar ‘failure’ of factor markets after the Middle Ages. In his contribution to this special issue, Bruce Campbell even argues that in England fairly efficient factor markets had already emerged in the centuries before the Black Death of 1348.

Although the geographical differences are large, and economic historians have studied factor markets in different societies and time periods, not much work has been done to analyse the functioning of markets from an international comparative perspective, nor are there studies that have sought to explain the divergent developments of factor markets in various parts of the world. Traditionally, other measures of performance – such as income per capita, real wages, consumption patterns and so on – have been used to assess the performance of countries and regions, and other elements have been put forward to explain differences in these respects, such as geography and climate, religion, culture, colonization and international trade. The absence of factor markets in recent debates on global economic history is most apparent in the discussion of ‘The Great Divergence’, or the huge income gap between Europe and Asia that emerged in the nineteenth and twentieth centuries.¹ Either factor markets are not dealt with explicitly within this debate or it is assumed that their functioning and efficiency were not very different in Western Europe from in China or Japan, as has been argued elsewhere by Ken Pomeranz, for instance.²

The articles in this special issue of Continuity and Change on factor markets were initially presented at a conference organized by the Global Economic History Network (GEHN) and the University of Utrecht in June 2005.³ The aim of the conference was to achieve a systematic comparison of the organization and development of factor markets in the centuries before industrialization, in the context of the Great Divergence debate. One of the underlying questions is whether and to what extent (the organization of) factor markets contributed to the start of modern economic growth in different parts of Western Europe in the eighteenth and nineteenth centuries, and to compare this with other regions of Eurasia (China, Japan) where strong economic performance is evident in the centuries before 1800. To answer this question, the authors were asked to describe the long-term evolution of the institutional framework within
which factor markets developed (or not) in different parts of the world, and, if possible, to assess the effects of these institutional arrangements on the relative efficiency of these markets and their contribution to long-term economic growth.

Describing the various institutions that governed the exchange of land, labour and capital in different parts of the world is difficult. Institutional economics has shown that factor markets are formed and embedded in the prevailing political, social and cultural arrangements of a society. Studying the divergent development of factor markets, therefore, implies a close analysis of the wider institutional framework in which such markets functioned. These institutions affected the costs and benefits of marketing land, labour and capital, and thus helped to determine the potential for technological change and economic specialization. A closely related issue, also linked to the historical genesis of factor markets, is the relationship between political structures and the development of factor markets, since political regimes often play an important role in the enactment and enforcement of rules for the protection and transfer of property rights. The degree to which these institutions protect property rights and enhance trust should, following North and De Soto, be one of the key elements in such an analysis.

To help answer these major questions and to develop an analytical framework for future research, this introduction contains first an attempt to conceptualize factor markets more precisely (in Section 2). Secondly, we address the question of how to measure their relative efficiency or performance (Section 3) and lastly we discuss the various links that exist between factor markets and long-term economic development (Section 4).

2. FACTOR MARKETS: AN ATTEMPT AT CLASSIFICATION

In discussions about factor markets, a distinction should be made between stock and flow variables. Property rights can be vested both in stocks – such as land, slaves (or labour power, to use the Marxian concept) and capital goods – and in the flows of ‘services’ from these stocks during a specific period (a day, a week, a month or a year): for example, labour can be hired, the use of land rented and capital borrowed. A further complication is the difficult concept of capital, for, on the one hand, it can refer to a monetary fund that can be used in exchange for payment of interest and, on the other hand, it can refer to actual capital goods such as houses and machines that can be leased out against the payment of a sum (and can, of course, be bought and sold). The latter market has not received much attention in theoretical and economic-historical research, nor will it be dealt with in this volume. Capital can obviously be borrowed: that is,
the flow of services for a sum of money during a specific period can be purchased by paying interest. What comes closest to a market in the stock of capital is the stock market, where money is exchanged against a small part of the ownership in a company and against a claim on a share of its profits.

Of course there are also intermediate cases, in particular the labour market combinations of stock ownership and flows. In medieval serfdom, for instance, the lord of the manor could claim a certain flow of labour services from a population tied to his land, to which he therefore also had certain ownership rights, or claims to the stock of labour power.

Factor markets are important, but it can also be argued that they are only one of the ways in which an economy can organize allocation processes. Networks (of families, merchants, guild members) and hierarchies (or power structures) are alternative mechanisms that can replace and/or supplement markets. An extreme example of an alternative mechanism for economic development is central planning, as, for example, was practised by the Soviet Union after 1929, where decisions to reallocate resources from agriculture (initially) to industry were taken centrally and enforced via a system of selective incentives. These included various forms of coercion in which markets played only a limited role. Medieval and early modern manorialism is another example of a mix of incentives in which hierarchy, coercion and reciprocity played important roles. Modern market economies are also based on a mix of markets, hierarchies (in big companies, the state, and households) and networks (between, for example, banks and industrial companies, among merchants and so on). But in market economies, actors to some extent always have the option of exchanging their factors of production in the marketplace, which sets limits to the degree of coercion hierarchies can impose, although this option might also be offered by alternative, non-market systems of exchange.

The idea that modern market economies are not governed by markets alone but are based on such a mix is explained in greater detail in the literature on the varieties of capitalism. Hall and Soskice in their seminal book on this topic compare two ideal types: liberal market economies (exemplified by the Anglo-Saxon countries) versus coordinated market economies (such as those in most continental European countries and most Asian economies). In the latter, coordination via non-market institutions (networks among government and companies, trade unions and employer organizations, banks and companies) plays a much larger role in the economic decision-making process than in the liberal, competitive market economies of the US and the UK. These different models have implications for the long-term performance of these economies. Clearly, both models are able to generate long-term economic growth, but Hall
and Soskice claim that liberal market economies are more suitable for radical innovation, whereas coordinated market economies are characterized by more incremental innovation, based on high levels of human capital formation.\textsuperscript{6}

The point is that there seem to be different institutional development paths towards a modern industrialized society, and that these can produce similar levels of economic performance, as the examples of Japan, Germany, Sweden and the United States demonstrate. Different sets of institutions can be mechanisms to re-allocate labour, land, and capital from low-productive to high-productive activities. A few examples from the articles below illustrate this point. In Western Europe and Japan, we see the rise of internal labour markets as early as the medieval and early modern periods. Guilds and, in the Japanese case, the merchant houses of Osaka and Kyoto played a large role in skill formation via apprenticeship contracts (see the article by Osamu Saito, below). Such systems were characterized by long-term contracts, systems of apprenticeship, and a relative stability of wages, whereas, by contrast, wages of casual labourers often fluctuated considerably from day to day or year to year. One of the arguments in favour of such internal labour markets is that they enable much higher investments in human capital. But it is also clear that this model deviates substantially from the ‘pure’ and perfectly competitive labour market deemed preferable in the more basic neo-classical approaches to the subject.

Internal labour markets can offer a solution to the problems of information asymmetry and adverse selection inherent in human capital formation. Similar problems exist in all other markets, and in particular in markets where transactions with a longer time horizon are organized, such as the capital market. Similarly, capital markets in early modern Europe and Asia were often embedded in networks of merchants, who were often members of the same (extended) family or clan, or who shared a common regional origin (the Lombards of medieval Europe, the bankers from Pingyao in eighteenth-century China), religion (Jews, Huguenots), or ethnic/national identity (the role of the Chinese or Arabs in Southeast Asia).

In explaining the highly divergent institutional arrangements that emerged over time, it is clear that social, political and cultural context play important roles. Although economic development in itself also affects institutions, it cannot be seen as an automatic response to economic needs, as is witnessed by the sharp differences in institutional arrangements as well as the persistence of institutions that are clearly not conducive to economic growth.\textsuperscript{7} The latter can partly be explained by path dependency: the self-reinforcing character of institutions, which is further
strengthened by the costs of institutional change and by the private in-
terests of social actors. The socio-political context thus greatly influences
the formation and development of specific institutions of land, labour and
capital exchange. Moreover, this context influences the effect of the in-
stitutional arrangements on economy and society, since it determines who
uses the institutions, from what positions and for which goals. This opens
a fruitful link to the analysis of social-property systems, since the effect of
institutional arrangements of exchange varies with differences in the social
distribution of land, labour, capital and the revenues flowing from them.
The functioning of factor markets in themselves can further influence
this social distribution in a feedback cycle, making it more equal or, on the
contrary, more skewed. The latter may have negative consequences on
society, ecological sustainability and economic development. A free land
market that enables concentration of land within a small segment of the
population, for instance, could result in a very unequal development path,
which most economists would consider to be sub-optimal for generating
economic growth, particularly because of the negative effects on invest-
ment in human capital.

To summarize, the institutional arrangements of factor markets can
vary greatly, mainly as a result of the different socio-political contexts in
which they emerge and develop and, even when similar, they can have
various effects on economic development, depending on the context. On
the other hand, different institutions may also generate similar long-term
trajectories of economic development. It is also clear that factor markets
do not have a monopoly on the allocation of factors of production; they
always coexist with networks and hierarchies as alternative means of co-
ordination and decision-making. This does not preclude the possibility of
investigating the efficiency of factor markets. Indeed, it may even be an
important indicator for assessing their functioning, and the extent to
which institutions enhance or hinder such markets.

3. THE EFFICIENCY OF FACTOR MARKETS

In institutional economics factor markets can be considered efficient when
transaction costs are low, which reflects well-respected property rights and
a high degree of trust between parties. Because it is almost impossible to
measure these transaction costs directly, testing the maturity or efficiency
of factor markets must therefore be more indirect. One approach is to
focus on the relative size of these markets; another is to investigate the
prices paid, since these reflect underlying transaction costs.

The focus on the size of, for example, the free wage labour force, or
the size of land and/or lease markets, is characteristic of the literature
on labour and land markets. The underlying argument is that when factor markets are efficient, households and other actors will allocate a larger share of their labour, savings or land via the market, rather than on subsistence production or non-market mechanisms. Poorly developed labour/land/capital market institutions will limit the degree to which households will use these markets, rely on them, and trust them. Therefore, when factor markets are large, this can similarly be seen as proof of their relative efficiency.

The second approach is to look at the prices paid. Institutional economists such as North have focused on the interest rate as a proxy for the efficiency of the capital market and of the institutional framework in general.9 The lower the interest rates are, the more efficient the capital market and the institutional environment are supposed to be. This assumes that interest-rate differentials among regions, countries and time periods are not the result of other factors, such as different time preferences or supply and demand factors. A similar argument has, however, not been advanced for the price of labour or land; no one has pointed out that low wages are an index of highly developed labour markets. By contrast, since Adam Smith, high wages have been associated with high labour productivity and an advanced stage of development. Similarly, high purchase and rental prices for land are generally considered as signs of advanced development, although they may also point to rural overpopulation and the concomitant fragmentation of land ownership or use.10

A complex case is that of the market for labour power, slaves and other forms of coerced labour. The logic of the argument so far suggests that a large and efficient market for slaves with low transaction costs would be conducive to economic development – in the same way that an efficient market for land is beneficial for growth. Most economic historians, even disregarding their moral objections to slavery, would probably agree that a free labour market is preferable to a slave market, and that slavery only seems to function efficiently in periods and regions of extreme labour scarcity, as suggested in the Nieboer hypothesis (as outlined by Boomgaard in his article here), and applied by Gareth Austin (see his article, below) to slavery as a system in West Africa in the early modern period. The issue is that slavery always implies some kind of coercion because the stocks traded have ‘agency’. Coercion is costly, however, and may affect the effectiveness of workers and their motivation. If alternative systems of labour supply are not available, these costs may not matter, but when coerced labour competes with free labour, these costs are significant and they will promote the decline of slavery or other forms of coerced labour.
4. THE DEBATE

The articles in this special issue all focus on the mix of institutions used in the historical societies under study to allocate land, labour and capital, and on the efficiency of those institutions. They contribute to a number of debates among economic historians.

Perhaps the most extensive debate concerns the Sonderweg (special development path) of Western Europe since the Middle Ages, a debate addressed by Campbell’s article on factor markets in England before the Black Death (below). He argues that in the two centuries before 1348 fairly efficient and extensive factor markets had already existed in this part of Western Europe. He also points out that in some respects England may have been a latecomer to the factor markets. In Italy, for example, capital markets were more advanced. Compared to the rest of Western Europe, England was also slow to dispense with labour services. The implication is that as early as the thirteenth and fourteenth centuries Western Europe pioneered relatively efficient factor markets, and this seems to be confirmed by quantitative measures. Literature on capital markets suggests that in the late medieval period interest rates in private markets in Northwestern Europe were declining to a level (of about 5–6 per cent), a level at which they have remained.11 Similarly, literature on labour markets and land markets suggests that in certain parts of Western Europe – in some regions of the Low Countries and in England in particular – these markets became relatively large in the late medieval period. Estimates of the proportion of the population in the early sixteenth century engaged in working for wages differ from one-third to perhaps as high as 60 per cent in certain regions.12 Land and lease markets in that period had become extensive, with about half of the land in the Low Countries being leased out for short terms, and this allowed for high land mobility.13 In the land markets in both England and the Low Countries, the annual turnover in the sixteenth century was about 2–3 per cent, not unlike that of the modern era.

How unique was this European experience? The country that may come closest to this model is Japan during the Tokugawa dynasty, where in the eighteenth and nineteenth centuries a well-functioning capital market with relatively low interest rates appeared.14 Similarly, its land market, which during the medieval period still lacked ‘coherent concepts of land ownership’, also developed rapidly after the unification of the country in the sixteenth century. As a result, during the Tokugawa dynasty tenancy increased to as high as 30 per cent in the most advanced parts of the country, and property rights became firmly established. The labour market remained relatively underdeveloped, however: while wage labour...
increased, and to some extent also replaced forms of coerced labour in the seventeenth and eighteenth centuries, the proportion of the population working for wages was limited.

West Africa and Southeast Asia offer two examples of very different developments. They had various forms of coerced labour on a relatively large scale, and more generally, poorly developed factor markets. In his article below Austin concentrates on why slaves were the main source of labour recruitment in the economies of pre-colonial West Africa, pointing out that economic factors – in particular labour scarcity combined with a demand for labour services – were of fundamental importance. Bonded labour (forms of debt peonage, serfdom, and people with heavy corvée obligations) was also important in Southeast Asia, probably more so than in South or East Asia, according to Boomgaard. Both Austin and Boomgaard discuss the links between state formation and slavery, the latter pointing out that overall there may have been a negative link between population density and slavery, ‘within such societies bonded labour appears to be connected to those core areas where a monarch rules over a sedentary population’ (see Boomgaard, below). Yet, in the most densely populated parts of Southeast Asia – Java, for example – ‘free’ labour markets slowly emerged from the seventeenth century onwards, although they remained small and fragile. Similarly, individual ownership of land, albeit on a relatively small scale, existed in the most densely populated parts of Southeast Asia, but often in combination with other forms of ownership and without the clearly defined ownership titles that became characteristic for Western Europe. Colonial states often added to the confusion by sometimes favouring communal property and sometimes introducing ‘Western’ property rights for Western enclaves. Capital markets in Southeast Asia were also, as Boomgaard points out, characterized by low trust and high interest rates.

Between these extremes of Western Europe on the one hand and Africa and Southeast Asia on the other, the Ottoman Empire in the early modern era and India in the eighteenth and nineteenth centuries are situated. As discussed by Sevket Pamuk, capital markets in the Ottoman Empire became more efficient, but institutional changes in land and labour markets remained limited in the period from the early sixteenth to the nineteenth century, as they were shaped by the interests of the central bureaucracy. In India, factor markets existed before British colonial influence, but they were weak and insecure. The institutional changes enacted by the colonial regime and the weakening influence of local power on markets stimulated market exchange of land, labour, and capital in this period (see Tirthankar Roy’s contribution, below). Property rights to land in the pre-colonial period, for instance, often depended on loyalty, religious
merit, or communal rights, and thus were not easily transferable. British reform of property rights to land in the period around 1800 changed this, and thus stimulated mobility of land in the market. This had many economic and social consequences, several of which were unintended. Nevertheless, cultural and social forces in India, Roy argues, also mitigated these effects and reduced the market exchange of land in ways not yet fully understood.

We end this brief survey with a few questions. It appears that Western Europe was different: it experienced a very early development of efficient capital, labour and land markets. It has been suggested that this was linked to the demographic pattern emerging in the same region, Hajnal’s ‘European Marriage Pattern’, which was based on strong links between households’ decision-making structures and market opportunities. We do not know enough about China yet (there is still a major debate about the efficiency of the land market; labour markets were probably more limited than in Western Europe; and capital markets had much higher interest rates); Tokugawa Japan was obviously developing in the same direction as Europe, but did so later. What might explain this early European lead? Which institutions or balance of societal forces caused the early emergence of factor markets there? Since factor markets are embedded in the political economy of the society they function in, the wider issue is: which balance of societal forces stimulated the development of ‘free’ and efficient factor markets? This is an issue that clearly needs further investigation. In view of the chronology now emerging (see Campbell’s contribution to this issue), the high medieval period seems to have been crucial in Western Europe, which means the causes for this should be sought there. This links to the ideas expressed by Britnell, for instance, who demonstrates that commercialization in England gained headway as early as 1000–1300, which was also a formative phase for the concomitant administrative, juridical and commercial institutions. As Britnell shows, at least implicitly, in England these institutions were to a large extent shaped by the interests of nobility and crown. But perhaps for continental Western Europe we should also look at the emerging territorial lords and the wave of horizontal associations, both urban and rural (merchant associations, town and village communities, guilds ...) that emerged in the High Middle Ages and assumed a prominent role here, probably more than in any other part of the world. These associations created a balance among socio-political interest groups that may have been exceptional in the global perspective.

Analyses along these lines may allow us to answer questions such as why, in certain circumstances, labour scarcity resulted in freeing labourers
from serfdom (a development that took place in high medieval Holland and northern Germany and in late medieval England), while in other circumstances labour scarcity was associated with the emergence or persistence of serfdom or slavery (which was the case in early modern Eastern Europe and West Africa). Why did coerced labour become considerably less important in early modern Japan and China? How important were the policies of these two states? Both tried to suppress slavery, as in Tokugawa Japan or in China abolishing its own, previously very extensive, use of coerced labour in the Ming and Qing dynasties. This is part of a more general trend towards market-oriented reforms in these two societies, which stimulated the development of factor markets in the early modern period.\textsuperscript{18} In Western Europe there was no such radical policy switch. In the Carolingian Empire (c. 800), the elite landowners still used slave labour on a large scale; it was only in the tenth and eleventh centuries that it fully disappeared or merged with serfdom,\textsuperscript{19} but at no point did the state – or the many polities that Western Europe consisted of in those times– directly steer this process.

In general we can conclude that the European early lead in the diverging developments that become so obvious later on should be situated in the early development of efficient factor markets in the medieval and early modern periods. While Japan and China seem to have begun to catch up in the seventeenth and eighteenth centuries, the development of factor markets in India and the Ottoman Empire was still delayed. Viewed from this perspective, Western Europe was considerably different, even long before the Great Divergence, because factor markets were more fully developed and more extensive and efficient than elsewhere. In Japan and China similar movements towards the increased use and gradual adaptation of factor-market institutions seem to have begun, but this was in very different political economies: that is, they were centralized states with a weak merchant class, and it is uncertain whether they would have had similar outcomes for developing efficient factor markets in the long run.

ENDNOTES

3 The articles on the land market presented at this conference (by Bas van Bavel, Markus Cerman and Ken Pomeranz) have been published previously, in Continuity and Change 23, 1 (2008). We should like to thank the Leverhulme Trust for supporting the Global Economy History Network (GEHN) and the organization of the Utrecht conference.


6 See also J. R. Hollingsworth and R. Boyer eds., *Contemporary capitalism: the embeddedness of institutions* (Cambridge, 1997).

7 Much more than in his earlier work, the notion that bad institutions often persist is manifest in North’s 1990 *Institutions, institutional change and economic performance*. See also S. L. Engerman and K. L. Sokoloff, ‘Factor endowments, institutions and differential paths of growth among New World economies: a view from economic historians of the United States’, in S. Haber ed., *How Latin America fell behind: essays in the economic histories of Brazil and Mexico, 1800–1914* (Stanford, 1997), stressing the interaction between the persistence of bad institutions and inequality.


19 P. Bonnassie, From slavery to feudalism in south-western Europe (Cambridge, 1991); P. Dockès, Medieval slavery and liberation (Chicago, 1982).