Известия на ЦСИИ / Proceedings of CEHR, Vol. 8, 2023

THE RISE OF THE MODERN STATE SINCE 1500: ANNUAL REVENUES OF EUROPEAN AND OTHER STATES

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DOI: 10.61836/ZSZR9855

Received: 28.06.2023
Available online: 21.11.2023

Abstract: *Recently, with the economic and political problems especially in developed countries and the Covid 19 pandemic, the place of the state in economic development is being debated once again. This presentation focuses on the simple ratio revenues as percent of GDP and summarizes the recently collected evidence about the growing role of the states in Europe and elsewhere during the last five centuries. It shows that revenues of states as a percent of GDP have been rising since the sixteenth century. This powerful trend began in Europe and has spread to the rest of the world including many of the developing countries since the second half of the nineteenth century. Historical examples going back to the era before the Industrial Revolution suggest that economic development took place not in countries where the state was small and weak, but in countries where a strong state supported economic development.*

Key words: state interventionism, Tax Revenues / Gross Domestic Product, power/capacity of the state, the place of the state in the economy, developed countries, developing countries

JEL: I31, I32, N34

One of the most fundamental and enduring questions in economics is about the place of the state in the economy and in the economic development process. What kind of a state is needed for economic development and whether the state should be strong or weak has been debated for centuries. Recently, with the economic and political problems in developed countries and the Covid 19 epidemic, the place of the state in the economy has come to the fore again.

According to one view, the most appropriate state for the economic development of a country is the small-scale state that does not collect much taxes. Advocates of this view say that the state should be content with ensuring internal and external security, enforcing laws, and protecting property rights. According to this view, only by keeping the state small will it be possible to prevent the state and administrators from harming the economy and keep the markets functioning well.

The second view, developed by economists and gaining strength in recent years, argues that the state has important functions in the economic development process beyond providing internal and external security and establishing the rule of law. Economists who support the second view point out that the market economy cannot function properly on its own, and that the state has important duties such as regulating and supporting the functioning of the market, enacting and enforcing the necessary laws for this purpose, and creating the necessary institutions (Besley and Persson, 2009; Epstein, 2000).

In the emerging literature, state capacity refers to the ability of a state to collect taxes, enforce law and order, and provide public goods. State capacity can be thought of as comprising two components, legal and fiscal. A high capacity state must be able to enforce its rules across the entirety of the territory. Second, it has to be able to collect enough tax revenues to implement its policies.

Economies governed by strong and cohesive states have been better able to overcome vested interests and avoid disastrous economic policies, while societies ruled by weak states are prone to rent-seeking, corruption and civil war. State capacity, therefore, can complement market-supporting institutions in providing a conducive setting for economic development. The link between greater state capacity and sustained economic growth depends on whether state policies complement markets and market-supporting institutions. The experience of the twentieth century teaches that attempts to build state capacity in the absence of the rule of law or a market economy have failed to generate sustained economic growth (Johnson and Koyama, 2017).

The emerging literature also emphasizes that the content of the state's support for the economic development process should change over time. For example, in the later stages of economic development, the state should focus on infrastructure investments, expand education and encourage the use of advanced technologies so that large segments of society can develop their talents and skills. In short, the second view emphasizes that a state that supports economic development is necessary for economic development.

Early Industrializing Countries

Looking at historical examples, we see that economic development took place not in countries where the state was small and weak, but in countries where a strong state supported economic development. In the process leading up to the Industrial Revolution in Western Europe, states in the Netherlands and England protected the domestic market by following economic policies called mercantilism, supporting merchants, domestic shipping and exports, strengthening domestic production and employment, and increasing the value added produced at home. Monetary stability, standardization of measures, investment in national transport networks were among the other important contributions of states to economic development in this early period.

In countries that started industrialization after England, the states also supported actively economic development. First in France, then in Germany, Italy, Russia and other countries, states pioneered the formation of new institutions and provided support to the private sector in order to close the gap between them and the UK. The state in the United States, which had advised developing countries to give up on customs barriers and protectionism until recently, followed protectionist policies for most of the 19th century, until it closed the gap with England in the industrialization process (Chang, 2002). In response to the world depression in the 1930s, the state's place in the economy began to expand again in these developed countries. After the Second World War, as the welfare state was embraced in these developed countries and the role of the state in education, social security and economic development expanded, capitalism experienced its golden age.

Today's Developing Countries

In today's developing countries, the power of the state and its place in the economy remained limited until the 20th century. As a result, these countries were not successful in the economic development process. However, with the deepening of the Great Depression in the 1930s, some developing country states, which saw that the existing model based on specialization in agriculture was blocked, supported industrialization for the domestic market by raising customs barriers, establishing state enterprises and applying various incentives to domestic production. This strategy, which was adopted by the vast majority of developing countries after the Second World War and would later be called import substitution industrialization, highlighted the role of the state in the economy. Again, after the Second World War, the important roles played by the interventionist states in the rapid industrialization process experienced in countries such as Japan, Taiwan and South Korea in East Asia, by choosing a sector, and even choosing a firm in some cases, and also in the adoption of advanced technologies are well known.

However, the existence of these examples does not mean that state interventionism will always yield positive results in the direction of economic development and industrialization. In order for state interventionism to yield positive results, state policies need to aim at long-term economic development, not the interests of this or that individual or group. State interventionism will be more effective when it is supported by effective institutions.

While all economically successful countries have had strong states which supported economic development, not all strong states in the past have supported economic development. There are many historical examples of states which have pursued policies that harmed economic development. Some states seeking higher revenue imposed higher taxes, destabilized monetary systems and supported monopolies. They also foreclosed and crowded out private technological and institutional innovations and preyed on autonomous economic organizations.

A Simple Indicator

In recent years, economists and economic historians have focused on a few simple indicators to measure the increasing power or capacity of states during the development process. One of the most prominent among these is the state's tax revenue. The state needs to collect taxes in order to be effective in various areas from internal and external security to infrastructure, technology and education, to operate the legal system effectively and to contribute to the economic development process. The ratio of the state's tax revenues to the total size of the economy (Tax Revenues / Gross Domestic Product as a percentage) stands out as the most commonly used indicator in recent studies that reflect the power or capacity of the state.

However, this ratio should be viewed not as a perfect indicator, but as a simple measure that can only approximately reflect the power and capacity of the state. In fact, arguments have been made in recent years that state expenditures, and more specifically, the composition of the expenditures would be a more appropriate indicator of state capacity (Ogilvie, 2022). Unfortunately, detailed data is not yet available for studying the expenditures of states in the earlier periods and it appears we will have to wait for some time before long term studies and comparisons focusing on state expenditures and their composition become available.

In what follows, I will provide a comparative overview of the pattern for Europe and the pattern for the rest of the world with emphasis on today's developing countries. This overview is based on recent work by myself, by my co-author Kivanç Karaman and the works of other scholars (Karaman and Pamuk, 2014).

The emergence of centralized states and the rise of state capacity was a long, complex and uneven process that took many centuries. As can be seen in Graph 1, the trends of the TR / GDP ratio over the last 500 years clearly reveal the differences between Western European countries and today's developing countries in rise of stronger central states that directed economic development.

Graphs 1 and 2 show that central states in Western Europe started to increase their tax revenues from the 17th century. The TR / GDP ratio rose above 10 % for the first time in the world, in the Netherlands and England, and then in other Western and Central European countries. After the adoption of the welfare state model in the second half of the 20th century, the same ratio rose to above 30 % in Western and Central European countries.

In contrast, as shown in Graphs 1 and 3, the TR / GDP ratio in today's developing countries remained below 5 % until the late 18th century. After remaining below 10 % in the 19th century and until the First World War, it exceeded 10 % only in the first half of the 20th century. In the second half of the 20th century, the average TR / GDP ratio of today's developing countries rose to 20 %.

This centuries-old difference between Western European countries and today's developing countries in terms of the structure and power of centralized states also enable us to better understand the ability of Western European countries to establish colonial empires by defeating weaker states in other parts of the world militarily and economically since the 19th century or even earlier.

In addition to the differences in social and state structures in developing countries in Asia, South America and Africa, the fact that these countries began to specialize in agricultural production for export during the 19th century and that industrialization remained weak until the 20th century, affected negatively the power of their central state. This pattern of late development in state capacity applied to most developing countries. Among today's developing countries, the TR / GDP ratios of those few countries which were able to maintain their independence did not follow a pattern very different than those which were colonized by European countries.

Ottoman Empire – Turkey

In Ottoman-Turkish historiography, it has always been written that the Ottoman state was powerful *vis-à-vis* society. However, as can be seen in Graph 4, the TR / GDP ratio remained low and contribution of the Ottoman state to economic development was limited. In the 17th and 18th centuries, a large part of the tax revenues were retained by powerful individuals and families both at the center and in the provinces. Most of the tax revenues that could reach the central government in Istanbul went to military expenditures. The power of the state was often not sufficient even for external and internal security, let alone economic development. Studies conducted in recent years show that the TR / GDP ratios of the Ottoman state as well as the Chinese state and the Mughal state in India remained well below 5 % until the 19th century (Karaman and Pamuk, 2010).

By examining Graphs 1 and 4, we can better understand not only how the Ottomans were able to defeat European states more easily in wars in the 16th century, when the central states in Europe were not yet strong, but also how the military balances began to change with the strengthening of the central states in Austria and Russia from the 18th century, leading to Ottoman defeats in later wars.

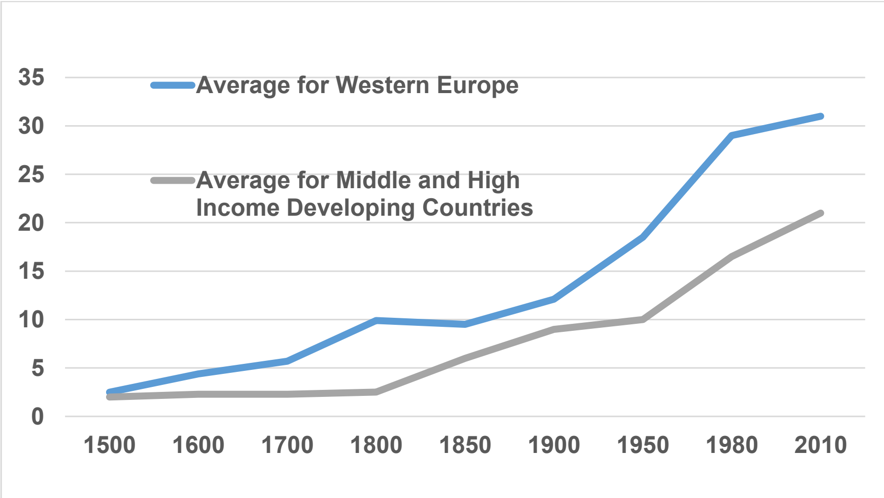
Again, by looking at Graph 4, we can gain additional insights into the reform process that started in the Ottoman Empire in the 19th century. After the military defeats of the late eighteenth and early nineteenth centuries, strengthening the central state became a vital issue for the Ottomans. Thanks to the increase in the tax revenues of the central state and the increase of the TR / GDP ratio above 10 % during the reform movement of the 19th century, it became possible to keep most of the large empire together until the First World War. In Graph 4, it can be seen that the TR / GDP ratio in Turkey continued to rise during the 20th century, increasing above 20 % and towards 30 % in recent decades.

Looking Ahead

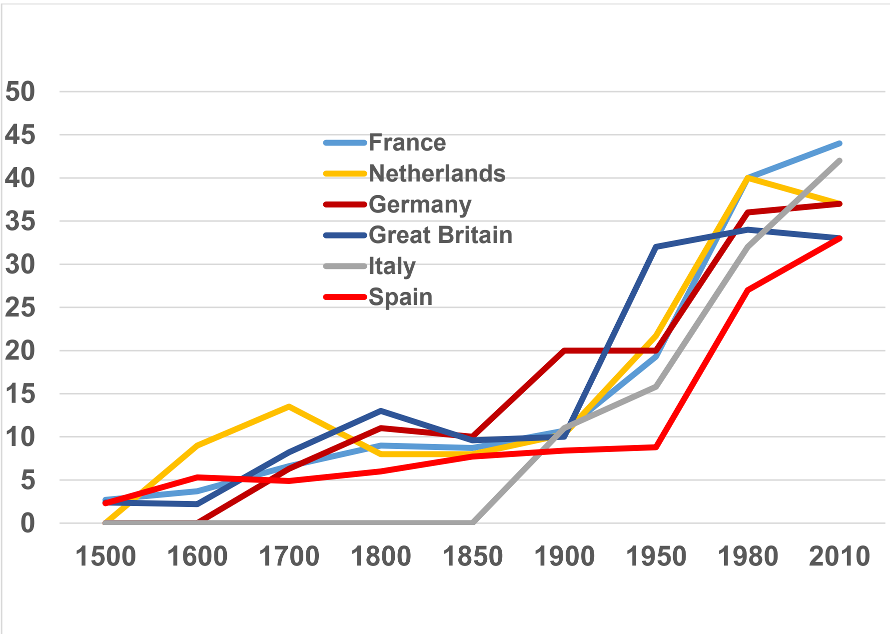
Recently, the problems raised by the neoliberal approach that favors a small state and the problems caused by the Covid 19 epidemic brought the role and importance of the state back to the agenda. While large support packages came into play in developed countries against the economic effects of the epidemic, the weak measures in developing countries reminded the importance of state capacity. The successes of state interventionism in China in recent decades also support the tendency to return to state interventionism in developed countries. The United States, which has long supported limits to the role of the state in the economy, has been giving signals recently of a return to protectionism and more active involvement of the state in the economy. We can expect developing countries to be influenced by this shift. In short, the pro-market trends that began in the 1970s and 1980s in many parts of the world are expected to reverse in the coming decades.

In concluding, we will underline once again that the outcomes of state interventionism across time and space have varied greatly. Since the 1930s, state interventionism supported industrialization and economic development in developing countries, but the results of state intervention have not always been strong. When state interventionism was used not to support more advanced technologies, not to support the more productive sectors and companies, but to create and favor individuals and companies close to the government, state intervention has often led to negative results. State interventionism will be more effective when society is able to regulate state practices and state interventionism is supported by effective institutions. For positive outcomes, there is not a single recipe and solutions imported from abroad are often not successful. Each society needs to search for and experiment with the institutional arrangements that lead to more favorable outcomes in their own context.

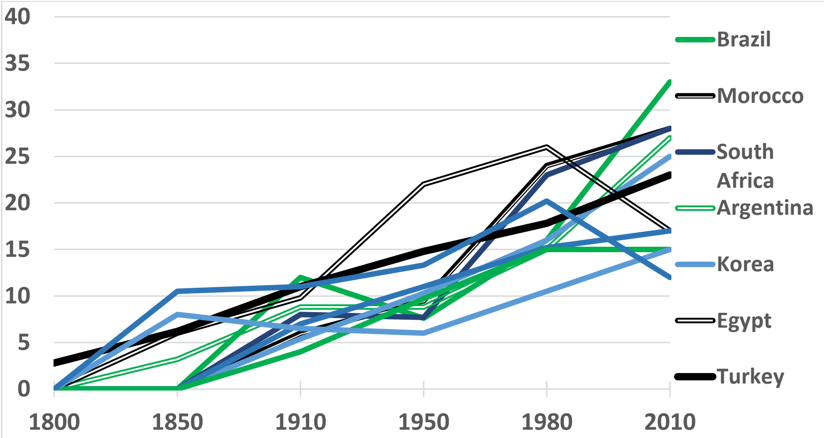
APPENDIXES



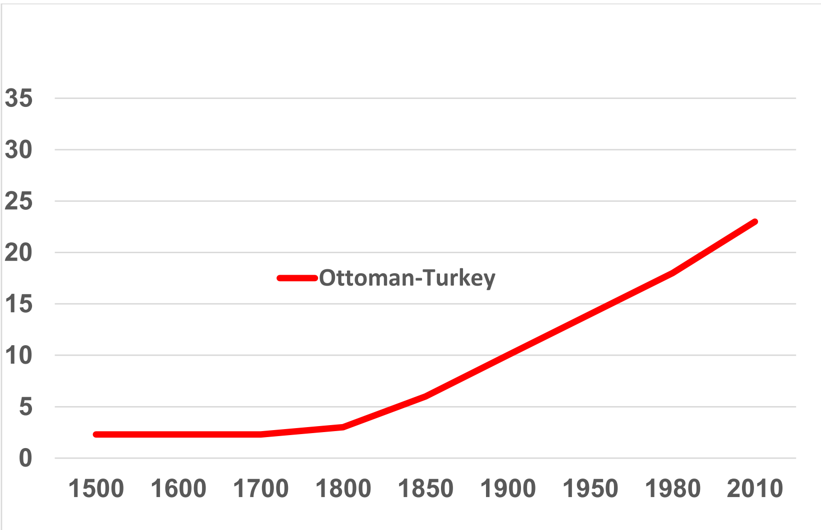
Graph 1. TR / GDP Ratios since 1500 (in percent)



Graph 2. TR / GDP Ratio in Western European Countries since 1500 (in percent)



Graph 3. TR / GDP Ratio for Developing Countries since 1800 (in percent)



Graph 4. TR / GDP Ratio for Ottoman Empire – Turkey since 1500 (in percent)

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