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HERRENHAUSEN CONFERENCE
HERRENHAUSEN PALACE, HANOVER

CONFERENCE SUMMARY
“Long-Term Processes of Socio-Economic Development: Stagnation, Growth, Divergence and Crises”

Organizers: Volkswagen Foundation in collaboration with Alexander Ebner (University of Frankfurt), Margrit Grabas (Saarland University), Uwe Sunde (University of Munich)

“Why are we so rich and they so poor?” economist David Landes once asked. The question has been debated in both economics and the social sciences for decades, and demands a better understanding of long-term processes of economic development.

Growth is usually thought of as a relatively stable process, and interruptions as a consequence of inconsequential structural hiccups. But development processes are subject to upheavals, asynchronies, and asymmetries that every now and then give rise to severe crises. And only in the past 200 years have we been able to observe a relatively continuous increase in wealth – and then only in certain parts of the world.

The goal of the Herrenhausen Conference on “Long-Term Processes of Socio-Economic Development: Stagnation, Growth, Divergence and Crises” was to delve deeper into the ongoing inquiry into the character, dynamics, and determinants of long-term socio-economic processes in national economies.

In her opening keynote, economist DEIRDRE NANSSEN MCCLOSKEY (University of Illinois at Chicago) attacked the concept that economic development is a zero-sum game. While many attribute rising prosperity to an accumulation of capital, McCloskey said the accumulation of ideas has been far more influential. The remarkable rise in prosperity over the past two centuries is the result of a
widespread societal willingness to accept a basic bargain: Let innovators innovate, and they’ll make everyone richer.

From a historical point of view, the fact that the Industrial Revolution took place in Europe is no accident. Societies had flourished before, from Song China to the Roman Empire. But they always failed to progress further. Finally, a series of historical events, like the Protestant Reformation and French and American revolutions, created a climate of liberty and a new emphasis on individual dignity in Europe.

That, in turn, created an unprecedented acceptance for innovation and innovators. Over time, this led to an improved standard of real equality, shrinking the real gaps in living conditions: A poor person in 1800, for example, was much less well off compared with the King of England than the average person today is compared to a billionaire.

Economic historian JOEL MOKYR (Northwestern University) argued that the most important single contributor to the epoch of modern growth was the development in the 17th and 18th centuries of a market for ideas — the so-called “Republic of Letters”. It was made up of scientists, theologians, astronomers, mathematicians, alchemists all across Europe, linked by a newly reliable postal service and catalyzed by the printing press. The network’s far-flung impersonality was one of its strengths. While its members were relatively homogenous, literate and religious but open-minded, their weak ties to each other made proving their claims using replicable results paramount.

To adopt an economic metaphor, the Republic of Letters was a market for ideas, based on reputation as currency. Innovators tried to persuade “buyers” to accept ideas. If successful, they “made a sale” and gained in reputation when their idea was accepted.

Because of Europe’s fractured political landscape, intellectual capital could move freely: Rulers were unable to control the production of knowledge, because innovators could always move to places where patronage was more forthcoming or their ideas were welcomed.
In a less sunny view of the prospects for continued growth, sociologist JOHANNES BERGER (University of Mannheim) made the case that humanity may have trapped itself on a hedonic treadmill of consumption. While Mokyr and McCloskey both ended their presentations on optimistic notes, confident that the technological progress seen over the last two centuries would continue apace or even increase, Berger suggested innovation had already begun battering its head against a wall of diminishing returns. If the “big ideas” have already been invented, the exponential economic growth humanity has enjoyed for the last 200 years may soon flatten out. Once less developed nations successfully adopt and implement the transition to modernity, they’ll catch up to the developed world — and their growth will slow, too.

To test the hypothesis that less copyright protection led to an increase in innovation, economist PETRA MOSER (Stern School of Business, NYU) turned to the World War II Book Replication Program. As part of wartime laws implemented to seize enemy-owned property, the US government re-assigned German-owned copyrights to American publishers, who then published books (often essential reference works in fields like chemistry and mathematics) at a steep discount — sometimes as much as 20 percent of the original, copyrighted price.

By comparing the seized German books to Swiss books sold under copyright in the same period, Moser showed that cheaper (and hence more accessible) intellectual property was cited more widely. The German books had an increase in citations five times as high as their Swiss controls. Moreover, improved access to books increased innovation, as measured by patents.

Historian WERNER PLUMPE (University of Frankfurt) made a plea for government to stay out of economics. Using historical data, he argued that political action can diminish economic output, but not increase or stabilize it. Rather than politicians stabilizing economies, stable economies lead to periods of political stability. As an example, he showed that economic crises in the US after 1913, when the Central Reserve Bank was established in reaction to a series of financial panics, were as severe as those before. Part of the problem is the reactive nature of political interventions in the economy: “Politics is always dealing with the last crisis,” Plumpe said. “But the crisis behind us is a historic crisis, and the one we’re dealing with now is the present one.”
For economic historian Harold James (Princeton University), a little crisis is a good thing, shaking up ossified institutions and often leading to innovation, reform and improved institutional frameworks. He cited Jean Monnet’s dictum “Europe will be forged in crises, and will be the sum of solutions adopted for those crises.”

But the need for creative destruction is at odds with our desire to live in a world of stable legal and political circumstances: Social stability requires stability of expectations. To strike a balance, policymakers must negotiate “trilemmas”: The optimal balance between capital mobility, democracy and international order, for example, or capital mobility, financial stability and fixed exchange rates.

With two centuries of boom-bust cycles behind us, it’s not so unreasonable to look for predictive patterns in the history of economic crises. Moritz Schularick (economist and economic historian at the University of Bonn) said we’ve been looking for patterns in the wrong place. After analyzing 223 business cycles, he concluded that the focus on public deficits is a distraction: Only by taking a close look at private borrowing, such as mortgages, can we accurately predict the next bust.

The more a boom relied on private borrowing, the worse it was and the longer it took to bounce back. As the world realized in the post-2008 recovery, housing bubbles financed by debt are a major risk for the whole economy, while bubbles financed by equity (like the dot-com boom in the late ’90s) have less of an impact.

The consequences of severe economic crises extend beyond the marketplace, of course. Too often, economist Robert Boyer (Centre d’Etudes des Langues Indigènes d’Amérique [CELIA-CNRS] Paris) said, societies lurch from crisis to war; regime change and political turmoil—often brutal and violent—is closely linked to economic upheaval.

And yet major crises are often catalysts for positive changes, as well. Wars and crisis can generate collapse that allows emergence of superior socioeconomic regime. World War I, for example, was the catalyst for major economic innovations in Europe, from the entrance of women into the work force to personal income taxes.
Development, in other words, is an uneven process, mixing technological change and innovations in organizing society. While crises and wars have been crucial to the emergence of socioeconomic regimes, politicians today must find ways to mimic the disruption of war, without war. That, Boyer acknowledged, is very difficult.

Historical examples illustrate the tremendous power of crisis to promote innovation — sometimes on extremely long time scales. Economists James Foreman-Peck and Peng Zhou (both Cardiff University) argued that the Black Death, in a chain reaction that could never have been foreseen, helped make the Industrial Revolution possible 500 years later.

When the bubonic plague swept across Europe in the 14th century, the resulting death of people led to societal shifts like a rise in the age of marriage for women. That, in turn, meant women could have fewer children over their lifetimes, thus increasing the value of human capital (and pulling women into the work force) and creating incentives for innovation.

We don’t just have the Black Death to thank for the Industrial Revolution. Economic historian Neil Cummins (London School of Economics and Political Science) argues that Europe’s morals played a role too. Monogamy — standard practice in Europe — turns out to be a global and historical anomaly: Eighty-five percent of societies in the anthropological record allow men to take multiple wives. Among the outliers are either small and marginal cultural groups or history’s greatest civilizations.

Along with monogamy comes a high age of first marriage and a large percentage of unmarried females. By decreasing fertility, the marriage pattern paved the way for the Industrial Revolution, during which family size declined as per-capita incomes rose. A similar phenomenon can be seen in the decline in violence among Europe’s upper classes: As each individual became worth more, the costs of killing became intolerable.

While most of the attendees looked at broad economic data to understand socio-economic developments, psychologist and behavioral scientists Anuj Shah (University of Chicago Booth School of Business) borrowed tools from psychology to understand the decision-making processes of the
poor. While the poor are typically dismissed as bad economic decision-makers, they’re often more rational about spending money than people with higher incomes. Poorer people think of expenses in terms of tradeoffs and opportunity costs, which is smart economic thinking.

So why are they still poor? Shah suggests the problem lies in limited mental bandwidth. With poverty come more worries and stress, which reduce the attention people are able to devote to financial planning. Automatic enrollment in retirement and savings accounts and direct transfers of social welfare benefits give people the mental space they need to make better decisions.

One of the most effective long-term investments society can make is early-childhood education, particularly as fertility decreases and human capital quality becomes more important to maintaining growth. Early childhood daycare results in better socio-emotional outcomes later in childhood, increased income equality and more belief in self-determination and empowerment.

Based on data from Germany, the US, Norway, and other countries, economist KATHARINA SPIEB (German Institute for Economic Research, Berlin) brought an important nuance to the idea: Not all early-childhood education is created equal. Educational programs must be high-quality to have an impact, and even then the return on investment is highest for programs targeted at disadvantaged children’s earliest years. Yet a disconnect remains: In Germany the group that stands to benefit most from early-childhood education programs — low-income immigrant families — have the lowest attendance rates. That’s a mistake in the long-term; countries could save on secondary and tertiary expenditures by investing more in early care.

The conference’s final presentation offered an ambitious look at economic preferences across cultures. While deep determinants like history, climate and geography shape development, economist UWE SUNDE (University of Munich) said that proximate determinants — physical capital, human capital, and culture — do too. Sunde’s research group collected survey responses and economic data from 80,000 participants in 76 countries to understand how.
The data set could help understand why people in some countries make different economic decisions than others. The preferences the study measures — traits like patience, risk-taking and the urge to get revenge — can predict individual behaviors including savings and schooling decisions, labor market and health choices and family structure. When compared across cultures and economies, these preferences could help explain aggregate outcomes and economic disparities.

Following a call for proposals for travel grants, 21 early career researchers were also invited to actively participate in the conference. The conference featured various poster sessions and presentation slots for three minute lightning talks. The presentations were well received by the conference participants and included topics like “Can the Growth Pole Strategy be a Panacea for Africa’s Long Term Economic Development Challenge?”, “Long-Term Socio-Economic Development Through Harnessing the Demographic Dividend”, and “Holding on? Ethnic Divisions, Political Institutions and the Duration of Economic Declines”, to name only a few.

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