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Economic Analysis of Institutional Change in Ancient Greece

Politics, taxation and rational behaviour

Carl Hampus Lyttkens



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Economic Analysis of Institutional Change in Ancient Greece

This book presents an economic analysis of the causes and consequences of institutional change in ancient Athens. Focusing on the period 800–300 BCE, it looks in particular at the development of political institutions and taxation, including a new look at the activities of individuals like Solon, Kleisthenes and Perikles and on the changes in political rules and taxation after the Peloponnesian War.

The process of institutional change in ancient Athens is analysed with the methods and concepts of New Institutional Economics. This brings a fresh perspective to the understanding of the development of Athens. Using an economic theory-based approach allows different questions to be asked and different aspects of the ancient society come to the fore. This approach differentiates this book from previously published works on Ancient Athens.

This economic paradigm provides a consistent framework that allows us to apply its conclusions to the modern world. Relevant lessons include the ubiquity of unforeseen consequences, the fact that motivation for change usually comes from people trying to prevent something unpleasant from happening rather than trying to achieve some positive and specified goal, and repercussions from trying to divide the population into groups with different privileges. It is valuable reading for all economists, economic historians and classical scholars who believe that a modern theoretical approach can better help us understand the lessons of the past.

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Preface

“There is nothing new under the sun”, said the ancient Romans. This certainly has some bearing when we compare our society today with the ancient world. Ancient Greece and Rome gave birth to so very many of the ideas and concepts for human interaction that are still with us today. The people we meet, for example, in the speeches held in the Athenian courts in the fourth century BC seem very much like the people you read about in your daily newspaper or on the Web. In their speeches, they complain that other people try to avoid taxation, they find their spouse in bed with somebody else, they quarrel about their inheritances and so on. Judging by newspaper reports, one of the reasons for the current problematic situation in Greece is that paying your taxes is not something you do unless you actually want to, you do not pay taxes just because the law says that you should.

The premise of this book is that we can learn a lot about the ancient economies by applying modern economics to their situation, but also that we can use the ancient experience as a historical laboratory to gain insights of a general nature that are applicable to contemporary society.

In particular, we can use the ancient societies to study the mechanism involved in institutional change. Institutions, as Douglass North has suggested (1990, p. 3), are the rules of the game in society, the humanly devised constraints that shape human interaction. Institutions can be formal, such as legislation, or they can be informal, such as social norms. They shape the incentive of the actors in the economy and determine what kind of behaviour will appear to be in the individual's best interest. Thereby the institutional structure determines how well the economy functions, the level of affluence, the development over time and the distribution of income. To explore the processes involved in institutional change is therefore of paramount importance if we want to explain what makes some societies successful and others not.

Perhaps it is because I have lived in Sweden so long that I find one institutional feature particularly fascinating. This is the rules of taxation. When I began studying economics in the late 1970s, the marginal rate of taxation on personal income was above 90 per cent in Sweden, and that was without taking the payroll tax into account (in a true Orwellian tradition this tax is labelled “employer fees”, but in reality, of course – Sweden being a small open economy

– the tax burden is mostly shifted to the employees). If nothing else, this provided great teaching material: for example, one could show that the taxation of income from capital actually *reduced* overall tax revenue.

To the modern mind, the most salient fact about ancient Greece is arguably that they developed a set of political rules that entailed direct democracy (for men). How and why this came about is also a central theme in this book. But the Athenians produced many other almost equally fascinating institutions, and this helps us explain the mechanism of institutional change. I am also happy to note that putting this manuscript together has left me with as many new questions for future research as answers to old ones.

Since my first studies of the ancient societies, the world around me has changed. It is no longer the case that Finley's position – that economics is disqualified in the study of ancient societies – dominates the field (Finley 1973, 1999). A number of classical scholars and economists are now increasingly arguing in favour of using economic analysis to explain what went on in ancient Greece and Rome. This pertains in particular to New Institutional Economics, which I use here.

My ambition has been to write a book that is accessible to a wide audience. The economic analyses are not presented in the form of mathematical models (which would put some people off). For those who are relatively unfamiliar with the ancient world, the historical background is briefly sketched in Chapter 2, the nature of the evidence is discussed in section 1.6, and a Glossary is provided on pp. 143–145 that explains ancient Greek terms (as well as a few economic ones). This I hope will enable fellow economists, classical scholars, and anybody who shares my interest in the ancient societies, institutional change or taxation, to read this book.

For the format of ancient names (and terms) I mainly follow the lead of the great Danish scholar Mogens Herman Hansen in his 1999 book on the ancient Greek democracy. Consequently I mostly use the equivalent of Greek name forms, but with some exceptions because some names seem so very well-known in a Latinised or Anglicised version (i.e. the form in which they are found in an English dictionary). So you will find in the text, for example, Kleisthenes rather than Cleisthenes, but Aristotle (not Aristoteles).

To have the opportunity to study the ancient world is a great privilege. It is a different world, but at the same time very familiar. My interest in ancient history goes back a long time. I cannot date it with certainty, but two books that I received as a gift when I was 14 years old definitely established a lifelong interest. The author was Alf Henriksson, a learned man, who also happened to be a highly productive creator of short poems about Life, the Universe and Everything (yes, *The hitchhiker's guide to the galaxy* is another favourite). In two volumes, he tells the history of the ancient world, but with a special emphasis on the tall stories, the yarns, the juicy gossip etc., which so many ancient authors were happy to convey to us. It is through him that I have learnt such useful things as the fact that Diogenes lived in a barrel, Demosthenes used to train his speech with pebble-stones in his mouth, and the Roman emperor Maxminius

Thrax's favourite pastime was to knock out the teeth of horses with his bare hands.

When I began my university studies, I had the opportunity to study the things that interested me; consequently I started off with parallel studies in Art History and Mathematics, and gradually drifted into studies of the ancient world. So when I came to economics¹ I had already made friends at the Department of Classical Studies in Lund where I had studied for one-and-a-half years, including a three-month course at the Swedish Institute of Archaeology in Athens. A few years after my Ph.D. in economics, I decided to try and mix my new and my old fields of interest. Since then I have refused to let go of my interest in antiquity, though I have only had the time to tackle the ancient societies in my research at irregular intervals.

With the publication of this book a long-term ambition of mine has been fulfilled. Over the years I have published a number of articles on the ancient economy and society, with a view towards the long-term goal of writing a monograph on institutional change in ancient Greece in the archaic and classical periods.

This preface gives me a welcome opportunity to express my great gratitude towards all colleagues from different disciplines (economics, economic history, political science, ancient history, archaeology, philology, etc.) that have showed an interest in my work and provided friendly and constructive criticism at seminars, conferences, dinners etc. This includes a long list of friends: Lee and Alexandra Benham, and John Nye in St Louis, Margaret Levi, Yoram Barzel and Carol Thomas in Seattle, Peter Fibiger Bang and Vincent Gabrielsen in Copenhagen, George Tridimas in the UK, Ian Morris, Josiah Ober and Walter Scheidel in Stanford and many others. My continuing contacts with the people in classical studies in Lund has been vital for me, a far from exhaustive list includes Carol Gillis, Paavo Roos, Arne Jönsson, Eva Rystedt, Örjan and Charlotte Wikander and Anne-Marie Leander Touati. I should add that the ancient Greek that I know is due entirely to Staffan Fogelmark. The list obviously becomes even longer when we turn to my own faculty and the Departments of Economics and Economic History, so I limit myself to noting that Lennart Jörberg and Ingemar Ståhl supported me when I first began my ancient studies, and I sincerely hope that all the rest of you feel included in my gratitude.

Foremost among those that I am indebted to is without question Douglass North. He and his work on institutions and institutional change has been my most important inspiration over the years in my studies of the ancient economies. In addition to this, since our first meeting in 1989, Douglass and his wife Elisabeth Case have become my very good friends, and their hospitality has been endless. There has been many a nice morning walk with Douglass and his dog – from Clio to Kore and then Lizzie.

The final stimulus was a series of visits in the fall of 2011: I spent two weeks at the Saxo institute in Copenhagen, made a visit to St Louis and one to Stanford, and I am very grateful for the generous hospitality at all three places. A special word of gratitude goes to Vincent Gabrielsen for very helpful comments

on my chapter on taxation, and to three anonymous referees for substantially improving the manuscript. Anna Welander provided diligent administrative assistance in the final stages of the work. Obviously I am the only person responsible for any errors in the final version.

Financial support for this book project has come from several sources. A grant from the *Gyllenstiernska Krapperup Foundation* was instrumental by giving me time to put together the first version of the manuscript, and the same foundation generously provided additional means for the final preparation of the text. The visit to the USA in the fall of 2011 was financed by a grant from *The Foundation Rektor Nils Stjernquists forskningsfond*. The time for preparing the penultimate version of the manuscript materialized when I was granted sabbatical leave in the fall of 2011, for which I am very grateful to the Department of Economics and the School of Economics and Business Management at Lund University.

Finally, my eternal gratitude goes to my wife Kerstin – without her this book would never have come into existence. Though not an economist by profession, she understands not only theoretical economic principles but also how to apply them to everyday life. At timely intervals she has pointed out to me the opportunity cost of spending my time and research efforts on projects other than the completion of this book (“Do you want to write this book or don’t you?”). She is also the perfect companion when you are trying to find some archaeological remains lost in the wilderness, because she is a radiologist and her whole professional life centres around spotting the detail that marks a deviation from the usual. The same gift she has generously applied to scrutinizing my manuscript for errors of reasoning, spelling or anything that really should not be there.

Carl Hampus Lyttkens
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1 Ancient Greece, institutional change and economic analysis

1.1 Why ancient Greece and why Athens?

In 487/6 BC the Athenians decided that the archon – the most important state official in Athens – was going to be appointed by drawing lots among the candidates. This was an extraordinary idea: think about running France, the United States or Iran by drawing lot among the candidates for president. In Athens, this innovative method of appointment was later extended to many other posts.

In this way the Athenians ensured that all candidates had an equal chance of being selected for office. In addition, they made sure that offices were rotated among the citizens: nearly all government officials were appointed for one year only, each individual was only allowed to hold a particular post once in a lifetime and to be a council member twice, and you were not allowed to hold different offices in consecutive years. Taken together, this is a recipe for extremely widespread participation in the running of the state. Hansen (1999, p. 313) estimates that every third male¹ Athenian citizen above 18 gained practical experience of how it was to be a state official.²

The municipality where I live in Sweden counted around 110,000 inhabitants in 2010, which is roughly the same number of inhabitants as the citizen population of Athens in the fourth century BC.³ So running it on the same principles would mean that about 15,000 of the 44,000 male inhabitants above 18 years of age would at some point in time have been city councillor, or responsible for overseeing the serving of alcohol at the restaurants, or acting as a juror in the courts, etc. I think I can safely say that participation of so many inhabitants in the practical running of the municipality would have changed the nature of public administration in my home town dramatically.

The fact that the system of governance entailed such widespread participation was probably an important reason why the Athenians managed to run their state as a direct democracy for more than 100 years, in the face of serious challenges from other states and of opposition from elite groups within their own society, and to outdo their rivals in prosperity.⁴

The introduction of lottery in Athens was an institutional change, by which I mean a change in the rules of the game in society. These rules can be either formal (such as laws and regulations) or informal (such as social norms). It

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illustrates amply the general principle that institutional change is one of the most important factors for the future of a society. To explain what drives institutional change and to explore the consequences of institutional change are among the most important scientific challenges for the social sciences. This remains as true today as when Douglass North published his path-breaking book *Structure and change in economic history* in 1981.

For economic analysis, the ancient world is a largely untapped source of information about the mechanisms of different institutional set-ups and of institutional change. What we learn by studying those societies will help us explain the modern world. So, for example, an analysis of ancient Athens will increase our understanding of how a direct democracy works, and this can inform the current discussions about introducing more elements of direct democracy into modern constitutions, the referenda in the EU being a case in point.

The use of the term “democracy” for the political constitution that the Athenians gradually developed in the archaic and classical periods is not uncontroversial. It is of course well-known that it excluded women, non-citizens and slaves. The exclusion of women would certainly disqualify it as democracy in our time. The greatly reduced difference between men and women in terms of opportunities and outcomes in life is one of the most important social achievements of the modern era, together with freedom of speech and freedom of opinion (and a level of affluence that would have been unthinkable a century ago). Similarly, the presence of slaves would disqualify Athens as a successful society on moral grounds.

Nevertheless I use the word democracy, as do other scholars working in this area. It is also reasonable. In the words of Kurt Raaflaub (2007b, p. 12): “We are simply not in a position to deny that the Athenians had a democracy, even if we believe that it does not fit *our* concept of a democracy. After all they invented the word...”. The word *demokratia* appears for the first time in the fifth century and was used frequently.

The level of democracy in ancient Athens is also astonishing. It is remarkable to find 2,450 years ago a society where all major political decisions were taken by majority vote in an assembly of all citizens, where every citizen had one vote and the right to speak and make policy proposals, where in practice all these citizens could hold even the most prestigious political positions, and where they were paid for doing so, which enabled more or less everybody to participate in the running of the state.

Different authors place the advent of democracy in Athens at different points in time, which is partly because they employ different definitions of democracy (Raaflaub, 2007b, pp. 14f.). I will not enter the definitions debate, but will certainly have something to say about the timing and significance of different democratizing measures. I will use the terms democratizing and democratic pragmatically, and will consider an institutional change to be democratic if it (a) extends political power in terms of participation in political decision making or (b) extends access to offices to a larger part of the population.

This book presents a story of institutional change – its causes and consequences. It is also a story about ancient Greece, in particular ancient Athens in

the archaic and classical periods. Why should we bother about the past, about what happened in Attica between 600 and 300 BC? The past is past and bygones are bygones, say you. Because studying the past is an excellent way of understanding the present, say I. Also, it is great fun.

This is also a story about ancient Greece written by a professor in economics. As I hope to convince you, applying New Institutional Economics (NIE) to the ancient world is a good idea for three reasons: (1) it helps explain what went on in ancient times, (2) the lessons regarding institutional change are often applicable to the modern world, and (3) we learn more about the potentials and limitations of economic theory.

By focusing on ancient Athens we can look into the mechanisms that produced a remarkable male democracy, made it successful and kept it going for more than a century. We can contemplate the interaction between institutional change and economic development. We will see the value of an economic rational-actor framework that helps explain what might otherwise appear as a set of divergent developments.

The archaic and classical periods in ancient Greece are fascinating in that seldom in human history has the pace of change been so dramatic. The outcomes have wielded a long-lasting influence, in particular on Western society and how that society views itself. Ancient Greece is also a magnificent laboratory for those interested in economic and political institutions. However, as mentioned above, this source of knowledge has hardly been tapped, and I hope that this book will stimulate many colleagues to join me in the study of the ancient world. In fact, the number of contributions from economists to the study of ancient Greece and Rome seems to be increasing rapidly at the moment (and is not restricted to the NIE approach).⁵

In 600 BC, Athens was ruled by a birth aristocracy (henceforth all dates are BC unless otherwise indicated). Some 150 years later, the city-state of the Athenians was a direct democracy.⁶ To understand the mechanisms that produced such fundamental institutional change is an intriguing subject in itself, and one which has naturally been the subject of much discussion.⁷ As we shall see, a rational-actor perspective sheds additional light on this process and the individual incentives involved. While changes in a democratic direction in ancient Greece were not confined to Athens, the Athenian case is interesting because the institutional development in Athens is by far the most well-known. It also appears that Athens was probably the first Greek city-state to introduce such a far-reaching citizen democracy, and democracy was remarkably stable in Athens.⁸ In other words, this book is focused on the Athenian experience, both because of its intrinsic interest and because this is where our sources allow us to follow events in most detail. We will often deal with trends that are common to many city-states, but Sparta – the great adversary of the Athenians – followed a different path and will only concern us here to the extent that the Spartans and their actions influenced the development of Athens.

By studying the Greek experience we learn why institutions change. Institutions can, as mentioned above, be defined as the rules of the game in human

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interaction. This is the most important building block in a theory of why some societies are successful while others are not. Institutions are the key to explaining the success and problems of transition economies – China, Russia and others – as well as the progress (or not) of the developing economies (North, 1990). They are also the key to explaining why some countries have reached the level we call “developed”, and will determine whether these countries will stay ahead in the world race.

Until recently, economic analysis and the study of the ancient world would have seemed like surprising bedfellows. On the one hand, many who have read Sir Moses Finley’s influential book *The Ancient Economy*, which first appeared in 1973, probably still believe that economic analysis is not applicable to the ancient societies.⁹ On the other hand, while many fellow economists are interested in ancient history,¹⁰ I suspect that it may nevertheless come as a surprise that modern economics can help us understand the ancient world, and also that we can increase our understanding of contemporary society by studying the ancient societies.

The premise of this book is precisely that by applying economic analysis in a sensible way (“sensible” will be specified below) to the ancient societies, we can increase our knowledge both of the ancient world and of contemporary society and, indeed, of the relative usefulness of economic analysis.

1.2 New institutional economics – the toolkit

The scientific approach in this study is one of New Institutional Economics (NIE), in particular as formulated by Douglass North (1981, 1990, 2005). The Northian tradition is to view institutions as the rules of the game in a society, the humanly devised constraints that shape human interaction.¹¹ As mentioned above, institutions comprise both formal rules (political constitution, legislation, etc.) and informal rules (social norms, conventions etc.). This approach distinguishes institutions from organisations, which are important players; for example, families, companies, labour unions, and religious organisations.

Institutions shape the incentives of different actors in the economy, and they largely determine transaction costs.¹² Hence they are central to the functioning of society. An invariably topical example is taxation, which will figure prominently in this account. The rules of taxation have a large impact on whether economic activities take place in the open or whether they are hidden – hidden, that is, from the tax collector. To place an activity in the hidden sector of the economy may be preferable because of the tax savings involved, even though the activities in themselves are often less efficient there.¹³ The activities are relatively inefficient, for example, because transactions costs increase when a breach of contract cannot be resolved through the legal system; property rights are insecure which militates against long-run investments and so on. The nature of taxation in a society tells us (to be frank) a hell of a lot about that society, as I will argue in Chapter 6.