



Dignity and development

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ABSTRACT

This paper explores how expanding the notion of informal institutions in the broader institutional framework provides a more complete explanation for development. Specifically, I incorporate McCloskey's notion of 'dignity and liberty' as part of the institutional nexus. By doing so, a richer explanation and understanding of the importance of institutions in explaining different economic outcomes is offered. Focusing on bourgeois dignity offers a precise mechanism to explain how institutions matter to support economic growth. In addition, analyzing the changing attitudes toward the bourgeoisie provides a specific example of mechanisms that can lead to institutional change.

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1. Introduction

Understanding the causes of economic growth and development remains a central task of economics. Adam Smith (1776) highlighted the importance of such causes to the wealth of nations as secure property rights, rule of law, specialization under the division of labor and the extent of the market. These explanations are incorporated and expanded in modern economic analysis; however, many other 'possibilities' are proffered as the main causes that are out of line from a Smithian understanding. These explanations range from savings and investment, physical and human capital accumulation, geography, natural resources, domestic and foreign trade, the slave trade and colonialism, a protestant work ethic, and exploitation. The problem with such explanations is not that they are unimportant or do not affect economic outcomes. Instead, these theories miss the underlying incentives for why capital or technology, for example, is adopted and productive in certain societies and not in others. Proximate causes are confused with *fundamental* reasons for economic growth and development.

North and Thomas (1973, p. 2) capture this confusion when stating: "the factors we have listed (innovation, economies of scale, education, capital accumulation, etc.) are not causes of growth;

they *are* growth" (italics in original). Factor accumulation, whether physical or human, is only a proximate cause of growth and cannot explain cross-country differences (Olson, 1996). Instead, the fundamental explanation of differences in growth is differences in institutions. North (1991, p. 97) defines institutions as "the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions, and codes of conduct), and formal rules (constitutions, laws, property rights)." In short, institutions determine the incentives to engage in productive versus unproductive activities ranging from economic exchange to rent seeking to respecting another person's rights.

New Institutional Economics (NIE) attempts to understand the wealth of nations by studying a country's formal and informal economic, political, social and legal institutions. Emerging from this literature is the conclusion that institutions matter a great deal – in particular, secure property rights institutions. Understanding how specific institutions structure and alter economic, political and social outcomes is somewhat more difficult to decipher. In addition, understanding the origins of institutions and mechanisms for institutional change remains elusive. An emerging consensus is that institutions are endogenous, suggesting that there are feedback mechanisms in play (for example, see Acemoglu and Johnson, 2005). Supporting this view is the idea that history and geography indirectly affect economic outcomes through lasting effects on current institutional structures (see Nunn, 2009 for a review of this literature).

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Deirdre McCloskey (2006, 2010) in her works on ‘The Bourgeois Era’ provides a unique and comprehensive view of the modern world. In *The Bourgeois Virtues: Ethics for an Age of Commerce*, she presents, convincingly, that not only do virtues support the market but also that capitalism nourishes the soul. Specifically, she explores how a bourgeois, capitalist, commercial society supports seven Western virtues (courage, temperance, justice, prudence, faith, hope, and love). Building from this story, in *Bourgeois Dignity: Why Economics Can't Explain the Modern World*, McCloskey undertakes a daunting challenge: to explain the sustained economic take-off beginning with the Industrial Revolution. Her strategy is to show that none of the material explanations (exploitation, foreign trade, investment, to name a few) can work alone, or in combination, to fully explain the factor by which income per capita has increased since 1700. What can explain it is that the bourgeoisie became free and dignified – channeling entrepreneurship into wealth creating innovation. Uniquely hers, she argues that why the change occurred is due to a change in the way people *talked* about markets and innovation – what she refers to as ‘sweet talk.’

The first goal of the paper is to create a general framework for understanding competing explanations for development. Secondly, I incorporate McCloskey’s ‘dignity and liberty’ into this broader institutional framework. McCloskey’s view on explaining the modern world offers a precise mechanism to explain *how* institutions matter to support economic growth. In addition, her work provides a specific example of feedback mechanisms that exist leading to institutional change.¹ Therefore, in my view, McCloskey is providing a specification of the ‘Institutions Rule’ hypothesis.

Liberty is closely related to the work on economic institutions, specifically, economic freedom; therefore, liberty is already assumed under the umbrella of ‘institutions’ and, for the most part, already incorporated in the institutional paradigm. Dignity, I argue, can also be considered as part of the institutional nexus – as another form of informal institutions, related but not identical to culture. Therefore, focusing on the role of informal institutions provides a bridge between McCloskey and the NIE. In addition, I suggest, as a way of illustrating one potential feedback mechanism for institutional change, that the change in ‘sweet talk,’ and thus, dignity, came about through the exchange of ideas that occurred with the rise in economic exchange. This section relies, in part, on the notion that the way in which individuals interact and integrate can lead to institutional change. It also highlights the feedback relationship between liberty and dignity.

The analysis can be viewed as twofold: first, it can be thought of as broadening our understanding of how *all* institutions shape subjective costs, thus providing the relative alternatives available for individuals to base their chosen means to pursue their chosen ends. And secondly, I am reinterpreting McCloskey’s work as an institutional explanation for economic growth and development. However, this should not be viewed as squeezing McCloskey’s original contribution into a narrowly defined, preexisting institutional framework. Instead, it should be viewed as expanding our definition of institutions and using McCloskey’s work to support the claim that institutions do cause growth. By doing so, we arrive at a much richer explanation and understanding offered by either McCloskey or the NIE literature in explaining different economic development outcomes.

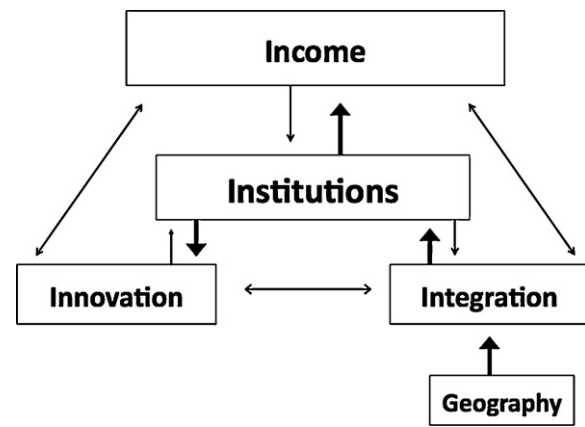


Fig. 1. Determinants of Development.

2. Institutions as fundamental

Before incorporating McCloskey’s ‘dignity and liberty,’ we need to create a general framework that provides an understanding of how the main ‘proximate’ explanations as well as the fundamental institutional causes of economic development fit together.² Fig. 1 is provided as a visual summary of what the literature classifies as ‘deep determinants’ of economic development. This includes how geography, institutions, innovation and integration fit together to explain income.³ This is by no means a comprehensive framework or covers all aspects of economic determinants; however, I focus on what has emerged as the leading explanations. The bolder arrows of the figure are the areas that this paper will cover as a means of incorporating McCloskey’s insights into the New Institutional perspective, although some of the other connections will be briefly discussed. To include all possible effects would be too much for one paper. Therefore, the main parts to be discussed are how institutions (which includes bourgeois dignity and liberty) determine income and innovation, and how integration (partly determined by geography) is a possible force for institutional change. This second part is only briefly covered, as a full analysis would require more space than allotted; however, it is mentioned as it helps to illustrate how McCloskey’s insights fit into our current explanations and also push us beyond our typical way of thinking.

2.1. Institutions → income

“The continued existence of society depends upon private property.” Mises (1978:87)

Institutions are the formal and informal rules governing human action. This includes not only defining such rules but also the enforcement of these rules. Enforcement can occur through internalizing norms of behavior, by social pressure exerted on the individual, or through the power of external enforcers. Institutions are fundamental because they structure and determine the way in which all other activities, including political, economic, and social, take place (or do not take place) within society. Institutions provide the context for individuals to act. They alter the relative costs or payoffs to engage in activities, including exchange or entrepreneurship to innovate. People innovate, or invest in human or physical capital, or trade, when they have an incentive to do so. What shapes incentives is the institutional structure individuals face.

¹ It should be noted that McCloskey is attempting to explain the take-off and sustained economic growth that occurred around 1700–1800 that is associated with the Industrial Revolution. Therefore, parts of her argument may not directly apply to current reasons for poverty in some countries.

² The point of this section is not to provide a survey of the literature; therefore, many important articles related to specific topics may be omitted.

³ This figure is adaption from Rodrik et al. (2004).

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