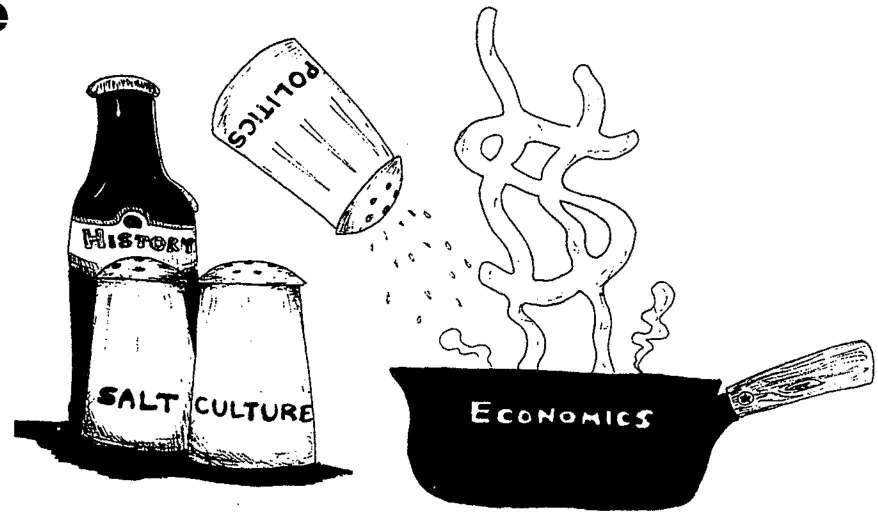
LSE - AMA - gi : Journal of the LSE Hayek Society, Vol. 2, no. 1 (1998).

why culture matters:

economics, politics and the imprint of history

Peter Boettke adds culture and spice to the capitalist recipes of economic development



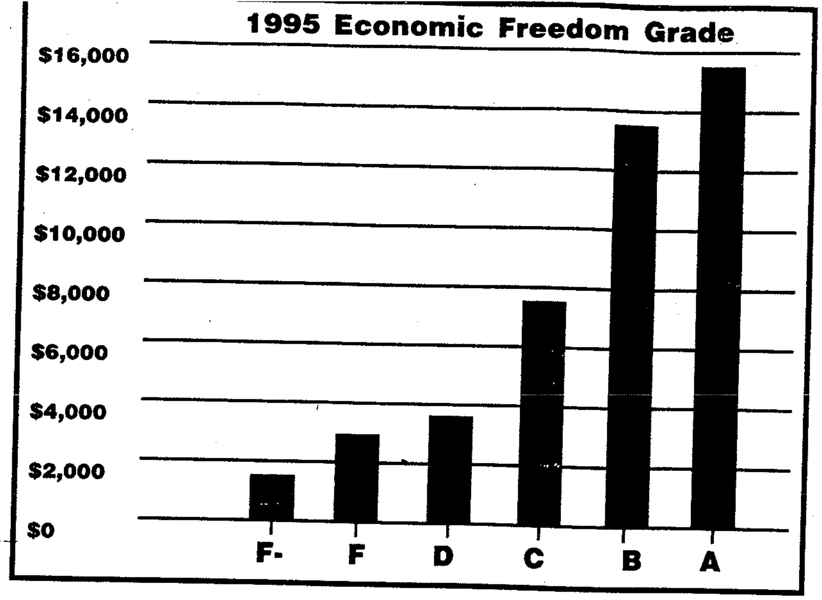
Is there some action a government of India could take that would lead the Indian economy to grow like Indonesia's or Egypt's? If so, what, exactly? If not, what is it about the "nature of India" that makes it so? The consequences for human welfare involved in questions like these are simply staggering: Once one starts to think about them, it is hard to think about anything else. — Robert Lucas

In this age of a shrinking globe, where world news travels almost instantaneously and computers link individuals from one continent to another, and financial markets follow developments from the most mature industrial democracies to the newly emerging market economies, why don't all economies converge to a single economic growth path? As Gregory Mankiw has recently stated: "It is apparent to anyone who travels the world that these large differences in income [i.e., the fact that average incomes in the richest countries are more than ten times as high as in the poorest] lead to large differences in the quality of life. Less apparent are the reasons for these differences. What is it about the United States, Japan and Germany that makes these countries so much richer than India, Indonesia, and Nigeria? How can the rich countries be sure to maintain their high standard of living? What can the poor countries do to join the club?".

Why can't economics — a discipline that has at least for two hundred years attempted to do so — explain the nature and causes of the wealth of nations in an unambiguous manner? Or are these questions just intellectual puzzles we have invented for ourselves? Mankiw, for example, highlights three problems that exist in the econometrics literature on growth (simultaneity, multicollinearity, and degrees of freedom). These problems question the ability of the "data" to adjudicate between different hypotheses on the causes of growth and development. But as Mankiw states: AIt is not that we have to stop asking so many questions about economic growth. We just have to stop expecting the international data to give us the answer". That conclusion, of course, depends on what the analyst means by "data" and "empirical" analysis. Aggregate macroeconomic data is not the only data available from which we can learn about the nature and causes of the wealth of nations — we can approach the question in a *multi-disciplinary* manner and incorporate arguments and empirical information developed in other areas of the social sciences, such as the results of case studies and the evidence gleaned from ethnography. In fact, a plausible argument can be made that the techniques and data we economists have come to rely on are too "thin" for our own good, and that perhaps it is high time we sought the "thicker" description provided by an ethnographic turn. In making this turn, individual decision making is not to be overlooked, but the context of decision moves to the centre of analysis as opposed to the behavioural assumptions, and economic actions are recognised as embedded within an environment, rather than disembodied and abstract. In other words, there is no necessary reason to jettison the methodological individualism — the hallmark of rational choice social science — but the methodological individualism practiced would not be the atomistic individualism of mainstream price theory. A more institutional individualism — which steers between both atomistic individualism and holistic institutionalism — emerges as the basic methodological starting point of analysis for political economy and social theory.

Context matters for economic

outcomes. The question does not turn on whether actors are more or less rational due to cultural background. The question turns on how alternative institutional contexts affect economic performance. We now have significant empirical evidence that the socialist model of planned industrialisation doesn't hold the answer to economic development. There are even significant theoretical arguments and factual evidence that what we once thought of (however begrudgingly) as Soviet industrial development was manufactured mismeasurement. On the other hand, we *do know* that market economies within a rule of law which protect private property rights and freedom of contract do demonstrate robust growth and lift the masses of such societies from subsistence and the struggle for daily survival. In a recent work by James Gwartney, Robert Lawson, and Walter Block which explored the relationship between public policy and economic development world-wide the findings presented were unambiguous. Countries which adopted policies which fit with the Gwartney, Lawson, and Block definition of economic freedom — namely personal choice, protection of private property, and freedom of exchange — outperformed countries which failed to adopt such policies. The components of their index included measures on how well the policy regime (1) protected money as a store of value and medium of exchange, (2) ensured the freedom to decide what is produced and consumed, (3) limited discretionary taxation and regulatory/legal takings so that individuals could keep what they earned, and (4) maintained open boarders for trade so that individuals were free to exchange with foreign parties. Each country was graded according to this index, and then the Economic Freedom grade was correlated with the Summers and Heston, Penn World Tables data on economic growth. As measured in 1985 US dollars, the average per capita GDP by 1995 Economic Freedom generated the following result:



This is not just the ideological wishful thinking on the part of classical liberal economists, it is an empirical proposition. Where is the example to the contrary? Where has an economic system which can be characterised as respecting private property, maintaining sound money, free pricing, and freedom of contract (including trade liberalisation) collapsed into economic depravation? Certainly the experience in the former Soviet-type economies and in so-called Third World experiments with development planning reflects poorly on the model of collective property, restrictions on trade, and governmental planning of economic life.

If this empirical proposition is right, then part of the puzzle mentioned above is solved. Economies don't converge because they fail to adopt "correct" public polices. But, this only pushes the question back to another puzzle. If we *know what* is necessary to make a miracle, then why don't we *know how* to make one? If the benefits from expanding the market are so overwhelmingly obvious upon reflection, then why don't all economic policy-makers converge to the "correct" set of policies? Robert Lucas in a paper entitled "Making a Miracle" put the matter simply — if we know what it takes to make an economic miracle, we should be able to make one. Who could doubt such straightforward reasoning?

Where has an economic system which can be characterised as respecting private property, maintaining sound money, free pricing, and freedom of contract (including trade liberalisation) collapsed into economic depravation?

But policies counter to economic logic are introduced everyday throughout the world, and economic theory is hard pressed to provide an adequate answer. Hard public choice logic can only get us so far in offering an explanation. It is true that the logic of concentrated benefits and dispersed costs is a formidable enemy to a democratically stable minimal state. There doesn't appear to be a sustainable winning coalition for the minimal state that can emerge out of normal democratic politics for more than fleeting moments, and such a fleeting coalition is certainly vulnerable in times of political crisis, especially war. The trend line of government involvement in the economic system is always upward sloping, but the great growth of government appears to result from the ratcheting up of government in times of crisis and the inability of democratic system to ratcheting-down after the crisis is over.

But autocratic governments don't suffer from this sort of "democratic sclerosis" so why don't they adopt the more encompassing perspective and simply establish an optimal tax? The autocratic — under the assumption of a secure time horizon — will secure the greatest amount of revenue by ensuring the highest possible growth and simply establishing an appropriate extraction rate. Why don't we see this outcome more often?

To start to grope for an answer to that question, what must be done is to square two seemingly contradictory propositions in a non-ad-hoc manner. Namely, the propositions:

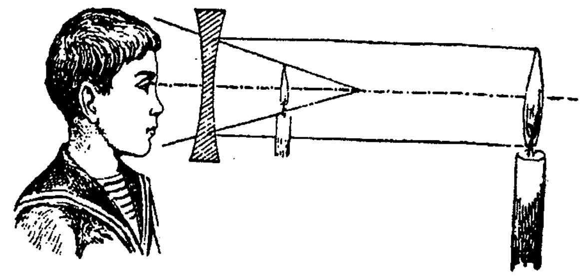
1. That we *know* more of *what* it takes to create an "economic miracle" than we often admit as economic scientists.

2. That we *know* less about *how* to make an "economic miracle" than we want to admit as economic policy-makers.

In demonstrating how both of these propositions can be correct, we must maintain the contrast between *know what* (or *know that*) versus *know how*. This distinction in the types of knowledge that we possess both as scientists and as actors within the model must be incorporated into our thinking about the social world if we hope to avoid the "constructivist" errors of which Hayek so often warned us. In doing so, perhaps we can offer an economic and epistemological argument for the lack of convergence between countries that is not only consistent with both propositions, but actually unifies these propositions within an analytical framework.

CULTURE AS THE CORE CONCEPT AND THE ECONOMISTS CRITIQUE

Could it be that the answer as to why economies diverge rather than converge in terms of economic growth lies outside of economic logic and rest instead in the fuzzy area of culture and history? The institutionalist critique of economics is that culture is a core concept that has been eliminated in the strive for universal explanation. Mayhew's argument is more subtle than I will present here, but the basic argument does boil down to the claim that "the core idea of culture comes under subtle attack when insistence upon the universality of instrumental reasoning becomes insistence upon the universality and centrality of a rational strategy of human behaviour and when the study of rational strategy comes to be seen as *the* important task of social science". Thus, the diversity of mankind defeats the strive for universal explanation and what standard economists assume as characteristics of human nature are instead behavioural regularities that are specific to time and place and persist because of enculturation. Outside of the particular time and place and the enculturation processes of the specific historical period and the assumptions of economic theory (as standard theory understands them) do not hold. In other words, outside of western capitalism, principles of economic theory do not hold. Of course, the institutionalist argument would be even stronger than that — challenging even the idea that standard theory describes western capitalism — but this would be a minimum implication of the argument. Beyond developed capitalism, economic theory doesn't hold. One cannot look to economic theory to solve the problems of poverty and depravation in non-western cultures. Solutions there must be found in the historical and cultural practices of the time and place under consideration. Culture and history are the core concepts of social analysis.



The problems with this reliance on culture as the core concept are that they ignore what we do know from cross sectional and time series analysis of economic development. Consider, for example, the classic economist rebuttal to cultural critics — the case of the three China's: Mainland China; Taiwan; and Hong Kong. Under the reasonable assumption that the population of these three regions are more or less homogeneous, sharing a similar cultural heritage, an examination of the development pattern of these regions differ radically on the basis of the economic institutions adopted. Rising above poverty is a consequence of adopting economic institutions approximating the private property, free pricing, sound money, and open trade program mentioned above. Economic backwardness is a consequence of deviation from that institutional recipe.

The gulf between Mayhew and Rabushka simply reflects the classic social science dichotomy between "thick" and "thin" description. Economists possess a penchant for "thin" description (and the scientific value of parsimony), while area studies scholars and historians value "thick" description (and the scholarly value of thoroughness). The social scientific methodological question for over a century has been whether meaningful "thick" description is possible without the guidance of "thin" description. On the one hand, "thin" description unconcerned with the underlying reality conveyed in "thick" descriptions describes little of relevance to our daily lives. On the other hand, "thick" description unaided by an articulated theory cannot help but bring on-board theoretical baggage that defies critical scrutiny. The social world is far too complex to access directly, our understanding must of necessity be theory impregnated.

We need, in other words, both "thin" and "thick" description for our social theory to possess both meaning and relevance — coherence and correspondence so to speak. To put it bluntly, if there was nothing universal in the human experience (the basis for "thin" description) then even our "thick" description of different people would remain beyond our ability to understand. Alien cultural practices would forever remain *alien* and inaccessible to others. At the same time, if all there were to the human condition was the universal, then culture and history and area studies in general would disappear. We could learn as much about a people by sitting at our computer as we would by studying their history. Both extremes of exclusivity in social explanation are obviously to be avoided. We need universal theory to understand, but we need uniqueness to whet our desire to understand *the other*. We are enough alike to learn from one another, but we are also different enough so as to have something to learn.

Thus, contrary to my non-subtle reading of the institutionalist critique of economics, economic theory must not be contrasted against the diversity of humanity and the particularities of time and place. Instead, economic theory is a necessary (though not sufficient) component of a social analysis which hopes to make sense of that human diversity and the particularities of the human experience. Institutions are constraints as well as shapers of human behaviour and social analysis must be prepared to deal with this complex interaction. The justification of the "thin description" of economic theory is that it affords us more compelling "thick descriptions" of the social experience of particular times and places. Rather than denying, for example, that principles of economics apply because cultural commitment preclude the buying and selling of cattle in Africa, one must open their eyes to the lived experience of Africans who trade their cattle in unlicensed markets. Fieldwork and ethnographic study, in this case, lead to an appreciation of the applicability of economic theory. The *de facto* everyday life of a people is what we want to understand, not the official life as dictated by government. In the former Soviet Union, for example, private property and markets were *de jure* non-existent, yet de facto attenuated private property and black markets were primary organising principles of social order. The experience in both Africa and the former Soviet Union (and elsewhere throughout the world from local trading in primitive bazaars to the high finance of international currency exchanges) suggests that markets exist everywhere and always, but not all markets are equal with regard to the properties of

Economic, political, and legal reforms are not just abstract impositions, but rather a process of growing economic, political and legal institutions within the native soil.

providing for overall progress and prosperity. Economic principles hold, but the welfare properties we associate with economic arrangements are a function of the institutional arrangement within which economic life is played out. The legitimacy of particular institutional arrangements within a people is a function of the "culture" of a people.

RULES AND THE EPISTEMOLOGY OF CUSTOM

The argument presented so far can be summed up in the following basic statement:

Economic performance is a function of the rules of the game.

Rules influence the strategies that players will employ, and the strategies that players employ reflect back on the desirability of the rules. We can study the evolution of basketball rules, for example, as a concern with the fairness and interest in the game under one set of rules when players (and coaches) discovered ways to exploit the existing rules to their advantage. Changes in the rules, do not transform the nature of the players, but they do affect what strategies players perceive as productive. Another way of stating the proposition above is simply to insist in the basic economic insight that *people respond rationally to incentives as they perceive them.*

"Rationally" in this formulation is nothing more than a basic notion of instrumental rationality and must be understood as entirely individually subjective and forward-looking. Only individuals act, and in acting they weigh costs and benefits of alternative ways to arrange their means to obtain the ends they seek. Their perception of the costs and benefits depends on the institutional context of their choices. The institutional context of choice is defined by the rules (both explicit and implicit) of the social game the individual is playing.

Economics is quite good at examining the consequences of alternative rules. But can economics help us understand why some rules can "stick" in one particularity, yet possess no meaning in another? What is required is a theory of institutional change and *acceptability.* Institutions, following the New Institutionalist literature, are defined as those formal and informal rules, which govern human behaviour. Culture, as I am discussing the term, refers to those beliefs and ritual practices which give institutions legitimacy. In order to develop a theory of institutional change and acceptability, institutions must be linked to culture. This is where the work of Carl Menger, Ludwig von Mises and F. A. Hayek may provide insights which could improve our account of social evolution. The example most often used in the Austrian literature of spontaneous grown institutions is money, though Hayek has extended the argument to law and markets in general. In Menger's theory of money, a common medium of exchange emerges out of a barter economy as individuals strive to overcome the double-coincidence of wants. By holding a more and more marketable commodities, individuals find that it expands their range of choices in market and fuels the

expansion of the division of labour in society. Individuals who hold more marketable goods as vehicles for indirect exchange do "better", and through a process of imitation the participants in the social process will settle on a common medium of exchange even though no one of them sought to invent money. Menger's theory demonstrated that money could indeed evolve spontaneously within the economic interaction of people — a central authority need not design and create a money.

Mises interpreted the implication of Menger's theory in even stronger terms.

One cannot step outside of history and design the appropriate development path. We may know what institutions are more amenable to wealth creation and material progress, but that doesn't mean that transformation is simply a task of "institution building".

Mises offered as an additional aspect of Menger's theory the "regression theorem". Technically, Mises' "regression theorem" employed marginal utility theory to monetary analysis to offer an explanation out of the circularity problem associated with the value of money. The value of money is determined by the purchasing power of money yesterday, but that is determined by the value of money. As Rothbard stated: "But how, then, can value scales and utilities be used to explain the formation of money prices, when these value scales and utilities themselves depend upon the existence of money prices?". The circularity problem — that X depends on Y, while Y depends on X — permeates all exchanges in a monetary economy. Mises was able to offer a solution to the problem by introducing the time component into the analysis of the formation of monetary prices. The reason why the introduction of time into the analysis doesn't just push the explanation back further is that the regression is not infinite. The value of money is rooted in both its exchange value and its historical value as a commodity under the conditions of a barter economy. The implication of which Mises argued was that "Business usage alone can transform a commodity into a common medium of exchange. It is not the state, but the common practices of all those who have dealings in the market that creates money". Not only did Mises' theorem confirm Menger's theory of the evolution of money, it also refuted alternative theories which argued that the state could consciously create a monetary system through a general agreement independent of commercial activity. In other words, whereas Menger's theory argued that commercial activity *could* generate a monetary unit, Mises' theory argued that the state *could not* create a monetary unit outside the context of the accepted practice of commercial life. It was epistemologically impossible for the State to create a common medium of exchange outside the context of exchange practice.

Mises' further development of Menger's theory of money was not limited to monetary theory, but permeated his formulation of the theory of monetary calculation within the market process. The evolution of money made possible the expanding of the division of labour and more roundabout processes of production which led to economic development. Monetary calculation, in Mises's formulation of the market process, is the key "aid to the human mind" which afforded advanced production and rational calculation of alternative investment opportunities by economic actors. In fact, Mises' did not simply extol the virtues of the division of labour as the engine of economic growth, he exalted the division labour to the central position in the general theory of social cooperation. The foundations of the liberal order were the recognised benefits of specialisation and exchange and the institutional preconditions

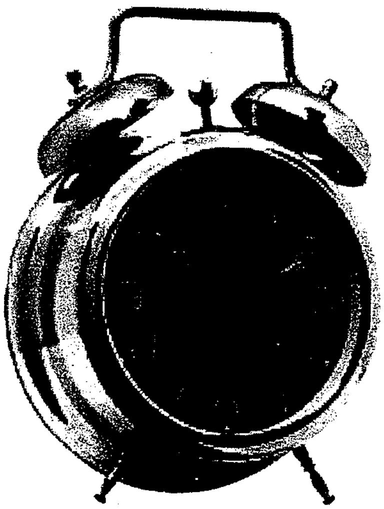
...culture and the imprint of history determine which rules can stick in certain environments.

necessary to realise those benefits, i.e., the respect for private property that emerged through the discipline of repeated dealings in the market.

Thus, in Mises's rendering commercial life and modern civilisation were the outcome of a process rooted in the trading behaviour of individuals and the expansion of that trading circle made possible by the emergence of a common medium of exchange. Outside the development of commercial norms of behaviour (and the evolution of institutions which afford and re-enforce these norms), and trading life.would be severely restricted and economic development beyond simple production would not be sustainable. Monetary calculation, in Mises' theory of economic interaction, is "the intellectual basis of the market economy". This, of course, is the foundational proposition which underlies Mises's famous critique of socialism. Socialism would have to forgo the "intellectual division of labour" of the liberal order that was made possible by monetary calculation. Aspects of this argument, however, permeate Mises's theory of interventionism and his theory of the unhampered market economy.

Hayek also used Menger's theory of money as a general exemplar of his research program and developed a particular argument about how the common law developed. But aspects of Hayek's argument with regard to the law also map Mises's regression theorem — though to my knowledge Hayek never made this connection. In Hayek's work on the law there is a contrast between *law* and legislation. Law emerges out of the evolution of the judge-made common law, whereas legislation is imposed from outside of the problem-solving situation of judges resolving disputes. Legislation has the power to thoroughly corrupt the social learning process embedded in customary rules. As Hayek put it: "The basic tools of civilisation — language, morals, law and money — are all the result of spontaneous growth and not of design, and of the last two organised power has got hold and thoroughly corrupted them.

Customary rules emerge from within a particular history and reflect the practices of a people as they attempt to resolve disputes. As one contemporary law and economics scholar has written: A Customary law is recognised not because it is backed by the power of some strong individual or institution, but because each individual recognises the benefits of behaving in accordance with other individuals' expectations, *given* that others also behave as he expects. Alternatively, if a minority coercively imposes law from above, then that law will require much more force to maintain social order than is required when law develops from the bottom through mutual recognition and acceptance. It is the reciprocal nature of the benefits of customary law that bind individuals to the system. The common law taps into the social learning embedded in custom as judges attempt to formally articulate what was previously held tacitly among social participants in a particular setting — it is in this sense they *discover* the law.



Market transactions exist across cultures and in all conceivable situations, but the rules which permit the transformation of market transactions into commercial progress must be ones which "stick". It is not due to an intellectual argument against "Western imperialism" that we must recognise that development is not an issue of simply either writing down the constitutional rules of a western-style democracy or copying the economic institutions of capitalism, but rather an *epistemological argument* about rules. It is true that economic performance is a function of rules, but rules are a function of "culture". Economic, political, and legal reforms are not just abstract impositions, but rather a process of growing economic, political and legal institutions within the native soil. Thus, we can conjecture a second — and just as fundamental — statement: **Rules are only RULES if customary practice dictates.**

There simply is no way to establish binding rules except through the translation of customary practice into rules of social interaction. As Hayek emphasised in many places, we did not design rules through our reason, but rather we developed reason because we followed rules. This is not conservatism, because no social rule is exempt from our critical scrutiny, but it is a position which insists that critique must of necessity always privilege some rule context while holding others up for examination — it is impossible to step outside of all context and employ *reason*. The *critical rationalist*, as opposed to the *rational constructivist*, realises that social experimentation takes place within a backdrop of the customary beliefs and traditions of society. Experimentation cannot be of the root and branch sort, but instead is limited to bold acts on the margin which if successful often loop-back and mutate previously held beliefs and thus lead to social change. Constructed, large-scale, attempts at social change which are not rooted in the *de facto* norms of existence of the current order are destined to disrupt social order and retard, rather than promote, social betterment.

This is not an easy conclusion for a classical liberal political economists, such as Hayek, to reach. The promise of material progress is not just a matter of adopting certain rules of the game, such as private property and freedom of contract. Economics may establish the properties of alternative rules, but culture and the imprint of history determine which rules can *stick* in certain environments. The problem is not one of private property and freedom of contract generating perverse consequences, but the fact that some social conventions and customary practices simply do not legitimate these institutions. If market transactions — which are universal — are constrained to a *sub rosa* existence, then commercial life and development will be limited. To move from that *sub rosa* existence, legal-political institutions must be adopted, but such adoption is only possible if there is a cultural fit.

One cannot step outside of history and design the appropriate development path. We may know what institutions are more amenable to wealth creation and material progress, but that doesn't mean that transformation is simply a task of "institution building". Of course, institution building — including questions of political

Modern life, on the other hand, demands that we develop moral rules for the anonymous society of the extended order.

governance — is a key factor in development (probably *the* key variable under our "control"), but some cultures are hostile and the necessary rules will not stick. This conclusion mirrors Hayek's other critical theory tension within the classical liberal project — that of moral rules for the extended order of the Great Society. If we are a product of rules that emerged in our evolutionary past, then we may be "hardwired" genetically for the face to face society of our tribal past. Modern life, on the other hand, demands that we develop moral rules for the anonymous society of the extended order. Thus, we are in tension with ourselves. Our survival now depends on the maintenance of the extended order, yet our inner selves long for a tribal past. In other words, even when the culture legitimates the institutions of commercial society, a tension exists between the abstract rules of the extended order and our atavistic urge for the intimate order.

Similarly, we may know what it takes economically speaking to create an economic miracle even though we cannot create one as we desire. The liberal promise — the simultaneous and mutually reinforcing project of individual liberty, economic prosperity, and peaceful co-existence between peoples and nations — can only be fulfiled if a peoples customary norms and belief systems are so inclined to legitimate liberalism. Lifting a people from beneath the struggle for survival is rare in history and is by no means a universal promise to all. The *only* path is an indigenous one independent of whether it is one of progress or stagnation.

In other words, we can assume that policy-makers possess only the best intentions, and that they *know what* it takes to make an economic miracle, but they will still be humbled in the face of social reality as the *know how* of economic miracles lies beyond their ability to articulate let alone control. In fact, and in an ironic manner, it is precisely because our *know how* of social cooperation exceeds our *know what* of social cooperation that the social dilemma can be overcome and advanced material production can be accomplished. As Peter Berger has argued, "it is quite clear that the state as such is not the bearer of development. At best, states can institute policies that leave room for the real agents of development — enterprising individuals, families, clans, compadre groupings, and other traditional units, and more modern associations such as cooperatives or credit unions"

SOME ILLUSTRATIVE EXAMPLES

The focal argument that I have made so far can be restated as follows:

1. People respond rationally to incentives.

2. Incentives are a function of the rules of the game.

3. Rules are only RULES if customary practice dictates.

Combine this argument with the subsidiary arguments that the international aggregate data (even if we put aside the problems of aggregation in general) cannot unambiguously arbitrate between competing hypothesis on the nature and causes of the wealth of nations, and that this sort of data cannot get at the customary foundations of the rule regime, and the upshot of the argument is that if we want to understand why some countries are poor, while others are rich, and perhaps even more importantly why some that were poor become rich, while others that were rich become relatively poor, then we have to open ourselves up to alternative forms of empirical argument. We have to find a way to understand the ideas, beliefs, habits that are indigenous to an area, and then see how the political, legal and economic institutions that are correlated with economic development fit in the social ecology. It is precisely in intellectually respecting the given social ecology that an answer to how we can square the two seemingly contradictory propositions with which I started the paper can be squared in a non-ad-hoc manner. Using economic reasoning, I am suggesting, we find out that we know quite a bit about what makes for economic progress, and part of what we know are that there are limits to what we can construct. As the prayer goes: "God grant me the serenity to accept the things I cannot change, the courage to change the things I can, and the wisdom to know the difference." Perhaps the secular version of that relates to our ability in political economy to learn the difference between the application of reason to social affairs, and the hubris of rationalism, between cultivating the social environment for enterprise, and attempting to control it to achieve optimality.

A rather "thin" reading of some cases (both negative and positive) can illustrate the point. In J. Stephen Lansing's study of the Balinese water temples, the argument is made that the embodied wisdom in tradition exceeded the scientific *know how* of Western experts on the production of rice. The water temples scattered across Bali were places of worship of various gods, they also managed the irrigation schedule. In the 1960s and early 1970s the International Rice Research Institute sought to eradicate the backward native practices of rice production throughout Asia — this was known as the "Green Revolution". Native methods of rice production would be replaced with a variety of rice that required the use of fertilisers and pesticides. In Bali, the government introduced an agricultural policy in conformity with the "Green Revolution" that promoted continuous cropping of the new rice. Rice farmers were encouraged to plant rice without regard to traditional irrigation schedules. The immediate effect, as could be expected, was a boost in rice production, but the policy soon resulted in a shortage of water and a severe outbreak of rice pests and diseases. The traditional method of rice production proved more efficient in managing resources than the scientific knowledge of high yielding rice production. In other words, customary practice was rooted in an understanding of the world which the enacted change failed to respect, and the result was an unintended undesirable outcome of good intentions in public policy.

But should modernisation and social change only be looked upon in the negative? As Peter Berger states "modernity does not appear on the traditionalists horizon *only* as a threat. It *also* appears as a great promise — of a longer and better life, of a plenitude of material goods, but also of individual liberation and fulfilment." Social

"it is quite clear that the state as such is not the bearer of development. At best, states can institute policies that leave room for the real agents of development — enterprising individuals, families, clans, compadre groupings, and other traditional units, and more modern associations such as cooperatives or credit unions

change and the discarding of myths are not to be always associated with failure. When social change begins with a respect for the customary practice and mutates, or when the customary practice already is conducive to economic experimentation (and the reward structure which induces such behaviour), then modernity's unintended positive side is revealed.

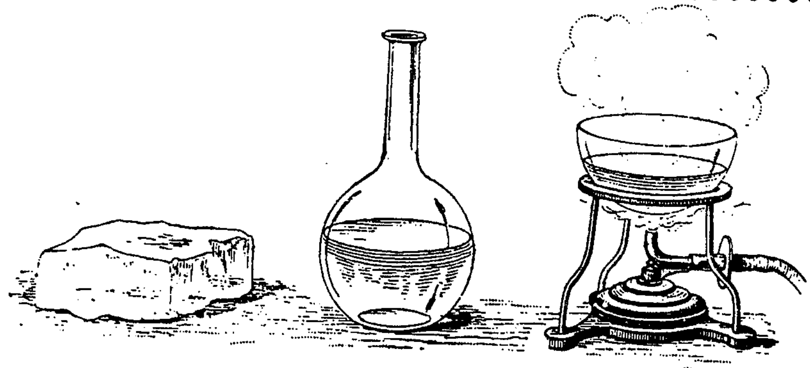
In Stephen Innes study of the economic culture of puritan New England, for example, it is argued that the social ecology of Puritanism led to the success of the Massachusetts Bay Colony in the seventeenth-century. A mutated cultural mix of British culture with Puritan ideology combined to free the economy of restraints and place moral sanction on private property and the work ethic. The fierce devotion to God in this case led to a social commitment to engage the world and prosper. This underlying customary belief system was reinforced by explicit public policy within the Puritan Commonwealth to promote economic growth and development. The Massachusetts Bay success story was not a result of "finding a treasure" in terms of rich natural resources, but rather requires explaining precisely because the success was from transforming a resource-poor environment into a thriving international economy.

In the past decade, New Zealand represents another example of such a transformation. As Gwartney, Lawson and Block point out: "In 1985, New Zealand was plagued by an expansionary and unstable monetary policy, restrictions on foreign currency holdings, high marginal tax rates, a large transfer sector, exchange rate controls, and capital market restrictions. Much has changed in the last decade." According to the index of economic freedom developed by Gwartney, Lawson and Block, New Zealand now ranks as the third most free economy in the world, and after years of sluggish economic growth, real GNP increased at an annual rate of 5.2% in 1993 and 6% in 1994. David Harper delves deeper into the causes of this transformation than the surface public policies adopted. Of course, the public policy aspect is vital (if you double the money supply you will double the price level), but what caused the shift in policy and what forces legitimate that shift are crucial questions to answer. Harper, attempts to get at the "intractable determinants" of growth that are embedded in a national culture is made, and he offers a comparative rating of New Zealand in terms of the acceptability of entrepreneurship. Harper contends, following Carson's work on entrepreneurship, that these cultural components are not intractable after all. Actually, Harper's analysis of the entrepreneurial content of New Zealand's culture is not wholly positive when compared to the US and Japan. But as he reminds the reader, a nation's culture is not static, but dynamic. His argument is that the changes that have occurred in New Zealand are mutating the culture in a direction further toward the entrepreneurial end of the spectrum. Harper further argues that a social ecology conducive to the entrepreneurial element must be embedded in an institutional framework.

Barry Weingast in an ambitious paper has conjectured that the appropriate institutional framework for development is what he terms "market-preserving federalism." In this work, Weingast examines the take-off periods of the Dutch Republic, England after the Glorious Revolution, and the United States in the nineteenth century. He then applies this argument to examine the contrast between Chinese and Russian reform efforts. The basic proposition in his paper is that the basic paradox of government — that a government strong enough to establish limits to its powers, is usually strong enough to break those bonds on its behaviour — has to be solved by the institutional framework of governance if economic agents are going to engage in the investment and entrepreneurial acts that lead to growth and development. The basic problem is one of political commitment — constitutional constraints serve to tie the ruler's hands.

The Dutch Republic example is an excellent one to highlight the issues raised in this paper. Again, the Dutch success was not due to "finding a treasure" of natural resources, but rather a result of cultural attitudes toward experimentation and ideas becoming codified in an institutional framework which led to an expansion of trade and innovation in the financial industry. One of the most common themes in histories of the Dutch Republic is the role of religious toleration which fuelled the growth of the population — the influx of new and varied people with different ideas and beliefs toward commerce, etc. — and thus the expansion of economic activity. The institutional framework and social norms (which gave rise to the institutions) were conducive to enterprise. As Reuven Brenner writes: "Whereas elsewhere people could, at best, buy or lease farms and other small properties, the Dutch, even of small and moderate means, could — and did — put their savings into shares in ships and mills, into fishing and trading voyages, and into the much-trusted loans to the city of Amsterdam, the province of Holland, or the United Provinces. The Dutch had the incentive to plough back profits and savings in commercial enterprises, an incentive people in other countries lacked." One interpretation of the difference between the Dutch Republic and other countries puts the causal weight on the decentralised nature of governance, as Weingast work suggest. "In two or three generations," Simon Schama states, "the Republic had risen from a ramshackle and beleaguered confederacy of towns and provinces into a global empire of apparently unlimited prosperity and power. ... It was, indeed, a phenomena. For the Dutch state drew power from federalism when absolutist centralisation was the norm."

A significant literature has emerged in the past few decades which explains the European miracle as an outgrowth of this polycentricism. The social infrastructure of polycentricism establishes limits to political opportunism, while also encouraging political (and decentralised units of social pressure, be they formal or informal) to discipline the opportunistic behaviour of others. The social ecology is one of secure commitments against confiscation, and thus one of trust in social dealings. If this is combined with cultural attitudes which tolerate dissent from old habits, then the entrepreneurial spur required for development will follow. The difficult task is to "maintain a society poised between tradition and change. This is the condition necessary for creativity, for the emergence of novelty, for prosperity". When these conditions are met, then the type of investment in more roundabout processes of production (and the emergence of financial



market institutions which lower the cost of this activity [including institutions of financial intermediation and insurance) that are associated with economic growth and development can be expected to follow. However, if the underlying cultural beliefs are at odds with the institutional framework of decentralisation and pre-commitment, then the institutions will lack legitimacy and fail to "stick".

CONCLUSION

Culture as a concept should not be held up in contrast to economic principles. The importance of culture as a core concept in social analysis can only be understood through the aid of economic logic. Economic logic establishes certain necessary, though not sufficient, propositions for social theory. Culture establishes limits to the *acceptance* of policy implications of economic logic in an above ground and transparent setting. When culture and economic logic coincide commercial experimentation flourishes and material progress lifts the masses of people from subsistence. Absent this coincidence, and the struggle for survival continues as economic behaviour is diverted either into a *sub rosa* existence or manifests itself in counter-productive "rent-seeking" games. Unfortunately, there is no escape from the struggle except through the cultivation of the indigenous institutions of a society in a direction more amenable to the rules of private property, freedom of contract and monetary responsibility.

by Peter Boettke, Professor of Economics, New York University

REFERENCES

Barnett, Randy (1992) "The Function of Several Property and Freedom of Contract," *Social Philosophy & Policy*, 9, no. 1.

Bates, Robert (1990) "Macro-political Economy in the Field of Development." In James Alt and Kenneth Shepsle, eds., *Perspectives on Positive Political Economy*. New York: Cambridge University Press.

Benson, Bruce. (1990) *The Enterprise of Law*. San Francisco: Pacific Research Institute for Public Policy.

Berger, Peter L. (1976) *Pyramids of Sacrifice: Political Ethics and Social Change*. New York: Anchor Books, 1974.

Berger, Peter L. (1985) "Speaking to the Third World." In Peter L. Berger and Michael Novak, *Speaking to the Third World: Essays on Democracy and Development*. Washington, DC: American Enterprise Institute for Public Policy Research, 1985.

Berger, Peter L. (1986) *The Capitalist Revolution*. New York: Basic Books.

Blewett, Robert A. (1995) "Property Rights as a Cause of the Tragedy of the Commons: Institutional Change and the Pastoral Maasai of Kenya," *Eastern Economic Journal*, 21, no. 4 (Fall).

Boettke, Peter. (1989a,b) "Evolution and Economics: Austrians as Institutionalists," and "Austrian Political Economy: A Reply," *Research in the History of Economic Thought and Methodology*, Vol. 6.

Boettke, Peter. (1990a) *The Political Economy of Soviet Socialism: The Formative Years, 1918-1928*. Boston: Kluwer Academic Publishers.

Boettke, Peter. (1990b) "Institutions and Individuals," *Critical Review*.

Boettke, Peter. (1993) *Why Perestroika Failed: The Politics and Economics of Socialist Transformation*. New York: Routledge.

Boettke, Peter. (1994a) "The Political Infrastructure of Economics Development." *Human Systems Management*, Vol. 13, no. 1.

Boettke, Peter, ed. (1994) *The Collapse of Development Planning*. New York: New York University Press.

Borner, Silvio, Brunetti, Aymo, and Weder, Beatrice. (1995) *Political Credibility and Economic Development*. New York: St. Martin's Press.

Brenner, Reuven. (1994) *Labyrinths of Prosperity*. Ann Arbor: University of Michigan Press.

Buchanan, James. (1993) "Asymmetrical Reciprocity in Market Exchange," *Social Philosophy and Policy*, 10, no. 2 (Summer).

Buchanan, James. (1995) "Economic Science and Cultural Diversity," *Kyklos*, 48, no. 2 (Fall).

Ellickson, Robert C. (1993) "Property in Land," *Yale Law Journal*, 102 (April).

Geertz, Clifford. (1973) *The Interpretations of Cultures*. New York: Basic Books.

Gellner, Ernest. (1994) *Conditions of Liberty: Civil Society and its Rivals*. New York: Penguin.

Gwartney, James, Lawson, Robert, and Block, Walter. (1996) *Economic Freedom of the World: 1975-1995*. Vancouver: The Fraser Institute.

Harper, David A. (1994) *Wellsprings of Enterprise*. Wellington: New Zealand Institute of Economic Research.

Third World Development. London: Routledge.

Hayek, F. A. (1973) *Law, Legislation and Liberty*, Vols. 1,2,3. Chicago: University of Chicago Press.

Hirschman, Albert. (1986) *Rival Views of Market Society, and other essays*. Cambridge: Harvard University Press.

Higgs, Robert. (1987) *Crisis and Leviathan*. New York: Oxford University Press.

Ikeda, Sanford. (1996) *The Dynamics of the Mixed Economy*. New York: Routledge.

Innes, Stephen. (1995) *Creating the Commonwealth: The Economic Culture of Puritan New England*. New York: Norton.

Israel, Jonathan I. (1995) *The Dutch Republic: Its Rise, Greatness and Fall 1477-1806*. Oxford: Oxford University Press.

Kuttner, Robert. (1997) *Everything for Sale: The Virtues and Limits of Markets*. New York: Knopf.

Lansing, J. Stephen. (1991) *Priests and Programmers: Technologies of Power in the Engineered Landscape of Bali*. Princeton: Princeton University Press.

Lucas, Robert. (1988) "On the Mechanics of Economic Development," *Journal of Monetary Economics*, 22, no. 1.

Lucas, Robert. (1993) "Making a Miracle," *Econometrica*, 61, no. 2.

Mankiw, Gregory. (1995) "The Growth of Nations," *Brookings Papers on Economic Activity*, Vol. 1.

Mayhew, Anne. (1987) "Culture: Core Concept Under Attack," *Journal of Economic Issues*, Vol. 21, no. 2.

McGuire, Martin, and Olson, Mancur. (1996) "The Economics of Autocracy and Majority Rule: The Invisible Hand and the Use of Force," *Journal of Economic Literature*, XXXIV (March).

Mischel, Kenneth. (1996) "Are we too thin for our own good?," Department of Economics and Finance, Baruch College, CUNY, unpublished ms.

Mises, Ludwig. (1980) *The Theory of Money and Credit*. Indianapolis: Liberty Classics, 1912.

Mises, Ludwig. (1981) *Socialism: An Economic and Sociological Analysis*. Indianapolis: Liberty Classics, 1922.

Mises, Ludwig. (1949) *Human Action: A Treatise on Economics*. New Haven: Yale University Press.

Theory," unpublished ms.

North, Douglass. (1990) *Institutions, Institutional Change and Economic Performance*. New York: Cambridge University Press.

North, Douglass and Weingast, Barry. (1989) "Constitutions and Commitments: The Evolution of Institutions Governing Public Choice in Seventeenth Century England," *Journal of Economic History*, 49, no. 4.

Olson, Mancur. (1993) "Dictatorship, Democracy, and Development," *American Political Science Review*, 87, no. 3.

Platteau, Jean-Philippe. (1994a) "Behind the Market Stage Where Real Societies Exist — Parts I, II: The Role of Public and Private Order Institutions," *Journal of Development Studies*, 30, no. 3 (April).

Rabushka, Alvin. (1987) *The New China*. Boulder, Co: Westview Press.

Raico, Ralph. (1994) "The Theory of Economic Development and the "European Miracle"." In Peter J. Boettke, ed. (1994).

Rodrik, Dani. (1996) "Understanding Economic Policy Reform," *Journal of Economic Literature*, XXXIV (March).

Rothbard, Murray N. (1993) *Man, Economy and State*. Auburn: The Ludwig von Mises Institute, 1962.

Rutherford, M. (1994) *Institutions in Economics*. New York: Cambridge University Press.

Sachs, Jeffrey D. and Warner, Andrew. (1995) "Economic Reform and the Process of Global Integration," *Brookings Papers on Economic Activity*, Vol. 1.

Schama, Simon. (1988) *The Embarrassment of Riches: An Interpretation of Dutch Culture in the Golden Age*. Berkeley: University of California Press.

Streeten, Paul Patrick. (1995) *Thinking About Development*. New York: Cambridge University Press.

Voigt, Stefan. (1993) "Values, Norms, Institutions and the Prospects for Economic Growth in Central and Eastern Europe," *Journal des Economistes et des Etudes Humaines*, 4, no. 4 (December).

Weingast, Barry. (1995) "The Economic Role of Political Institutions," *Journal of Law, Economics and Organization*, 11 (April).

Wittman, Donald. (1995) *The Myth of Democratic Failure*. Chicago: University of Chicago Press.