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Exposing the neoclassical fallacy: McCloskey on ideas and the great enrichment

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ABSTRACT

In this paper, I discuss Deirdre McCloskey's argument that 'ideas, not capital or institutions,' were the cause of the 'great enrichment,' the spectacular growth of the world economy since 1800. I disagree that the ideas of liberty and equality alone caused the great enrichment but agree that these ideas were central and necessary for it. Most theorists of development and economic history fail to recognize the importance of these ideas despite implicitly assuming them in what I call the 'neoclassical fallacy.' I also extend McCloskey's views to include a greater understanding of liberty and equality through their implementation, which necessarily involves institutions that provide political officials with incentives to honor these ideas in practice. Ideas of liberty and equality are not self-implementing, and most attempts to implement them fail. Finally, I argue that a range of political theorists from Hobbes to Madison studied the problem of implementing liberty and equality. In the 150 years prior to 1800, they helped devise a series of institutions that sustained liberty, equality, and the rule of law. These ideas also contributed to the great enrichment.

1. Introduction

In a recent contribution to this Journal, McCloskey (2016a) draws our attention to 'The Great Enrichment,' the spectacular growth of the world economy over the last two centuries and one of the most important events in human history. Economic growth was almost always flat prior to 1800, despite the efflorescences in Ancient Greece or Song China that produced impressive pre-modern growth of a factor two or five (Ober, 2015). In contrast, people are better off since 1800 by a factor of 30–100. McCloskey asks, how do we explain this unique and dramatic change?

McCloskey begins by listing previous hypotheses that she believes are not the underlying cause of the great enrichment. The list is long: the industrial revolution, trade expansion, hierarchical exploitation, the class struggle, capital accumulation, secure property rights, technological change, and institutions.

Juxtaposed to these promising but incomplete hypotheses, McCloskey argues that the central and largely unrecognized cause of the great enrichment involves a particular set of ideas and values, namely, liberty and equality. Liberty is a term that, unfortunately, has fallen out of use in the literature on economics, including economic history and economic development.\textsuperscript{1}

\textsuperscript{1}As to liberty, my primary focus in this essay, many of the great, mid-twentieth-century economists used the term, including Nobel Laureates, James Buchanan, Milton Friedman, and Friedrich Hayek. In their use, the term is often associated with views about the size and role of government. The term, 'freedom' is more modern, and McCloskey sometimes favors it over liberty. A better modern expression is freedom in the context of the rule of law. As to equality, McCloskey sometimes uses 'dignity,' an important idea that I will not discuss (see Ober, 2012 who also pursues this idea). North et al. (2009, Ch. 4) focus on inclusion, the idea that during the doorstep conditions and especially the transition proper, a larger set of people become incorporated as citizens.
In this paper, I disagree with a strong form of McCloskey’s argument, namely, that liberty and equality were the sole cause of the great enrichment; or, as she puts it in the subtitle of Bourgeois Equality (McCloskey, 2016b), ‘ideas, not capital or institutions, enriched the world.’ In what way are ideas causal? Are they necessary for the great enrichment? Probably. Are they sufficient in and of themselves? This seems unlikely. For ideas to have an impact, a series of conditions must hold. Ideas must – somehow – be translated from the realm of abstraction to the realm of action; that is, they must be implemented. Moreover, the implementation must be ‘self-enforcing’ in the sense that it gives political officials the incentives to honour and sustain these ideas as they become embodied in practice. Failing this self-enforcing condition, ideas will remain abstractions or produce unintended effects. The implementation of incentives for political officials of necessity involves various forms of institutions, as Hume, Montesquieu, Adam Smith, and Madison understood. Most countries that attempt to implement liberty and equality, rule of law, or a constitution with secure citizen rights fail to succeed (Cox, North, & Weingast, 2015; Elkins, Ginsburg, & Melton, 2009). These observations have two immediate conclusions. First, implementing liberty and equality is a difficult task that cannot be taken for granted. As I argue later, it requires more than widespread support among the people. Second, because the ideas of liberty and equality are not self-implementing, they cannot be the sole cause of the great enrichment.

I nonetheless agree with a weak form of McCloskey’s premise, that the ideas of liberty and equality are central, that is, necessary, to the great enrichment. I also agree that the importance of liberty and equality is woefully underappreciated in the literature. Although I criticise aspects of McCloskey’s argument, I view my approach as largely complementary to hers.

In this paper, I make four points that taken together contribute to our understanding of the importance of liberty and equality and how they work in practice. I call my first point the ‘neoclassical fallacy.’ In its study of markets, traditional economics makes a series of implicit assumptions about government. These implicit assumptions foster a fallacy, namely, that markets can exist without government. To be specific, neoclassical economics implicitly assumes: security, hence the absence of violence; a strong system of property rights and contract enforcement; and the absence of arbitrary or predatory behaviour by the state.

None of these conditions can exist without government. Markets instead exist in a symbiotic relationship with political institutions that foster various forms of market infrastructure, such as the rule of law; or, in McCloskey’s terms, liberty and equality. Put another way, economists often implicitly assume aspects of McCloskey’s hypothesis simply by beginning with markets subject to rule of law and an absence of violence.

My second point derives from my work with North and Wallis (North, Wallis, & Weingast, 2009). This approach holds that we cannot view developing states as incomplete versions of developed ones; for example, as possessing insufficient capital, education, markets good governance, democracy, and the rule of law. Although this statement is literally true – developing countries do lack sufficient levels of these important policies and institutions – development is not a process of adding components to developing ones. Yet so much of development advice proffers exactly this addition.

Development in the North, Wallis, and Weingast (NWW) framework involves the transition; that is, the movement from a limited access order to an open access order. In open access orders all citizens have the right to form organisations, subject to minimal restrictions. Open access orders therefore foster competition in both economics and politics. This form of society, characterised by liberty and equality in the form of access allows the entrepreneurial spirit of creativity and problem-solving emphasised by McCloskey. In contrast, developing countries are limited access orders. They limit access to organisations as part of a rent-creation process to hold the members of a dominant coalition together. In the face of decentralised violence potential, rents and privileges to the powerful make remaining in the coalition more valuable than fighting. Failing to limit access holds the risk that a powerful group in society is worse off than fighting. This condition explains why development is so difficult; the means of holding together the dominant coalition and therefore of controlling violence leads to the design of markets to generate rents, not for an efficient allocation of resources.
How does the transition from limited to open access work? NWW argue that the first stage in the transition is attaining three doorstep conditions (DCs): (i) rule of law for elites; (ii) a perpetually lived state and private organisations; and (iii) control over the various sources of violence.²

The relevance of the doorstep conditions for this paper’s purpose is that liberty and equality require the doorstep conditions and a little more. Limited access orders cannot sustain liberty and equality. Specifically, sustaining these ideas require rule of law for more than the elite; perpetuity of the state and organisations; and control of violence. Attaining liberty and equality is therefore deeply enmeshed with the development process qua transition.

My third point involves a central element in the problem to be solved. Many early modern political theorists, such as Locke, Montesquieu, Adam Smith, and James Madison – called the problem the arbitrary abuse of power. In today’s terminology, the problem of arbitrary power reflects executive moral hazard and government predation. Arbitrary power is inconsistent with liberty and equality. To be embodied in practice, liberty and equality require that the rules be predictable, as in the first two doorstep conditions. An absolute monarch with the power to alter the rules at will is inconsistent with liberty and equality.

Adam Smith recognised this problem in his discussion of feudalism in Book III of the Wealth of Nations (WN). Liberty and equality were absent from the violent feudal world. Smith argued that to invest and prosper in this world was to become a target. '[T]he occupiers of land in the country were exposed to every sort of violence. But men in this defenceless state naturally content themselves with their necessary subsistence; because to acquire more might only tempt the injustice of their oppressors' (WN III.iii.12, p. 405). The medieval world lacked the standard neoclassical assumptions of secure property rights, contract enforcement, rule of law, and a lack of violence. As Smith makes clear, the problem of arbitrary power and government predation – and an absence of liberty and equality kept markets from developing.

My final point involves the question, why 1800? In parallel with McCloskey, my answer involves ideas; in this case those of political theorists from Hobbes to Madison, whom I will call political-economists of development. In the 150 years prior to 1800, these theorists debated various ideas about liberty and equality: why did the states they lived in lack them and what were the means to create and sustain them? In 1651, Hobbes argued in Leviathan that an absolute monarchy was the only plausible form of state that could prevent violence and civil war. With the advantage of considerably more knowledge, we now know that Hobbes was ultimately proven wrong. But in 1651, I argue, Hobbes was right in the sense that no one then knew how to sustain a large-scale republic characterised by liberty and equality. Harrington (1656), Locke (1689), Hume (1739–1740), and especially Montesquieu (1748) made critical theoretical advances. A more complete understanding of how to implement liberty and equality did not emerge until Adam Smith, with his ideas reported in the Lectures on Jurisprudence (i.e., on law, government, and politics),³ and, especially, James Madison and coauthors in the Federalist Papers (F). In these works, political-economists of development figured out how to design and sustain a regime of liberty and equality. This theoretical knowledge proved critical to the implementation and sustaining ideas of liberty and equality in practice, as embodied in the U.S. Constitution. These ideas were therefore also necessary for the great enrichment.

The four contributory points add up to a larger understanding of liberty and equality and of ideas more generally. The neoclassical fallacy holds that most economic models implicitly assume these conditions as minimal conditions for competitive markets. McCloskey’s argument about the centrality of liberty and equality requires attaining and moving beyond the DCs to include, minimally, rule

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²McCloskey (2016a, p. 8) observes that ‘scores’ of states have attained these conditions in history, ‘from ancient Israel to the Roman Republic, Song China and Tokugawa Japan.’ Yet at any given moment, the number of such states is small relative to the number of limited access orders, and none prior to 1800 created a great enrichment.

³Although Smith burned his manuscripts on this topic, two independent sets of student notes on Smith’s course on jurisprudence survive and present nearly the identical ideas. The first set was published in 1896; the second set became widely available only in 1978. Many of Smith’s ideas on constitutional jurisprudence presage Madison by 25 years. Smith’s jurisprudence remains underappreciated. I explore these ideas in Weingast (2016)
of law for all, not just the elite. That is, these characteristics are necessary for liberty and equality. To be implemented, the DCs require considerable institutional development. Sustaining the first two doorstep conditions – that is, sustaining the rule of law and perpetual public and private organisations – requires a series of institutions that provide political officials with incentives to abide by limits on their powers implied by each of the DCs (Weingast, 2010). At the least, implementing liberty and equality requires a wide range of institutions underpinning a legal system that produces justice, the rule of law, and open access rather than corruption and limited access. Finally, implementing and sustaining liberty and equality required considerable development of other ideas, namely, how to sustain a constitution that prevented government predation and other forms of arbitrary power.

The early modern political theorists I have mentioned, among others, made major contributions to the institutional foundations of liberty and equality and, therefore, to the great enrichment.

2. The neoclassical fallacy

Traditional economics makes a series of implicit assumptions about government. Because these assumptions remain implicit, traditional economics suggests a fallacy, namely, that markets can exist without government. These assumptions are:

(a) Security, including an absence of violence.
(b) A strong system of private property rights and contract enforcement.
(c) The absence of arbitrary or predatory behaviour by the state.

None of these conditions can exist without government. As I have observed in, ‘The Economic Role of Political Institutions’ (Weingast, 1995), any government strong enough to enforce property rights and an absence of violence is also strong enough to confiscate the wealth of all its citizens. Too many countries fail to take the first path, an observation made by Adam Smith over two centuries ago that still holds today.

Although necessary to support thriving markets, the above conditions are not automatic. Indeed most countries that attempt to produce them in the modern world fail. The very limited success of the World Bank’s ‘good governance’ campaign provides evidence for this. So too does the observation that no attempt over the last 25 years to create elections in former war-torn states has produced a meaningful democracy.

The neoclassical fallacy appears in many forms. In his classic work on eighteenth-century philosophy, The Passions and the Interests (1977), Albert O. Hirschman argues that Adam Smith ‘maintains that considerable economic progress is possible regardless of improvements in the political environment.’ Hirschman then adduces this quote from Smith:

The natural effort of every individual to better his own condition, when suffered to exert itself with freedom and security, is so powerful a principle, that it is alone, and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often encumbers its operations. (Hirschman, 1977, p. 103, quoting WN IV.v.b.43, p. 540)

Hirschman concludes:

Smith affirms here that economics can go it alone: within wide limits of tolerance, political progress is not needed as a prerequisite for, nor is likely to be a consequence of economic advance, at least at the level of highest councils of government (Hirschman, 1977, pp. 103–104).

Hirschman clearly believes that markets can develop independently from government.


5 Given the important effects of the division of labour, what an immediate tendency it has to improve the arts, it appears somewhat surprising that every nation should continue so long in a poor and indigent state,’ Smith, Lectures on Jurisprudence, p. 521.
But Smith has said no such thing. A careful look at the Smith quotation reveals that he says, ‘The natural effort of every individual to better his own condition, when suffered to exert itself with freedom and security, is so powerful that it alone … ’ (emphasis added). Through Smith’s quote, Hirschman has slipped in the neoclassical fallacy, the assumptions of ‘freedom and security,’ as if they were automatic and had nothing to do with government. Yet, as I have said, freedom and security require strong assumptions about government that too-rarely hold. As McCloskey emphasises, we cannot take liberty and equality for granted. We must instead strive to understand the circumstances that produce them. McCloskey’s (2016a, 2016b) devotes a major portion of her recent work to explaining how these ideas developed and came to be seen as important and valuable characteristics of society.

3. The problems to be solved: arbitrary power of government and violence

To understand the emergence of liberty and equality, we need to understand its absence; that is, the problem to be solved. Many early modern political theorists emphasised two interrelated problems, both with deleterious effects on productive incentives: the problem of arbitrary government; and the problem of violence. Montesquieu perhaps states the problem of arbitrary power most clearly emphasising the incentives of arbitrary government on savings, investment, and hard work:

> Nature is just toward men. She rewards them for their pains … [and] attaches greater rewards to greater work. But if an arbitrary power removes nature’s rewards, the distaste for work recurs and inaction appears to be the only good. (Montesquieu, 1748, II.13.2, p. 214)

Similarly, ‘the lord, who can be stripped of his lands and his slaves at any moment, is not inclined to preserve them.’ (Montesquieu, 1748, II.13.6, p. 216)

Adam Smith emphasises the problem of violence in his work on political-economics, as studied in Book III of the Wealth of Nations (1776/1981) and as reported in the student notes to his Lectures on Jurisprudence, 1762–1763 and 1763–1764 (IJ, a and b).

> In the infancy of society, as has been often observed, government must be weak and feeble, and it is long before it’s authority can protect the industry of individuals from the rapacity of their neighbours. When people find themselves every moment in danger of being robbed of all they possess, they have no motive to be industrious. There could be little accumulation of stock, because the indolent, which would be the greatest number, would live upon the industrious, and spend whatever they produced. Nothing can be more an obstacle to the progress of opulence. (Smith, Lectures on Jurisprudence, p. 522)

The presence of the risk of violence and plunder – whether from roving bandits, stationary bandits (Olson, 1993), or other types of governments – induces men rationally to avoid hard work, initiative, and investment. Adam Smith explained the no growth feudal society in these terms. ‘[T]he occupiers of land in the country were exposed to every sort of violence. But men in this defenceless state naturally content themselves with their necessary subsistence; because to acquire more might only tempt the injustice of their oppressors’ (WN III.i.12, p. 405). Further, a ‘person who can acquire no property, can have no other interest but to eat as much, and to labour as little as possible’ (WN III.i.9, pp. 387–388). Smith argued that the feudal lords were constantly at war with each other, a problem that Cox et al. (2015) and North et al. (2009) emphasise as important throughout history, the modern developing world in particular.

The arbitrary exercise of power is common throughout the developing world. The median country in the world today experiences violent takeover of government – including coups, civil

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1Locke stated this point as: ‘This freedom from absolute, arbitrary power, is so necessary to, and closely joined with a man’s preservation, that he cannot part with it’ (17, §23). Further, Locke defined: ‘Absolute arbitrary power [as] governing without settled standing laws’ (72, §133).

2Although the Federalist Papers (F) are not commonly recognised for their the extensive discussions of violence, the American founders repeatedly warned about the problem of violence as a rationale for the newly proposed Constitution. For example, the after opening with a general introduction in Federalist #1, Publius devoted the next nine papers to various problems of violence: Federalist #2–5 focused on the ‘Dangers from Foreign force and influence’; Federalist #6–8 (and again in Federalist #41) on the dangers among the states, including war; and Federalist #9 and 10 on the dangers of faction, disunion, and insurrection.
wars, ethnic conflict – followed by major changes in the political rules once every 8 years. The richest developing countries fare little better – about once every 12.5 years. In contrast, the developed countries experience violent takeover only once every 60 years (see Cox et al., 2015). Sadly, liberty and equality are all too rare in the world.

4. Technical aspects of the emergence of liberty and equality: implications of the NWW framework

The NWW framework yields several implications for the political and institutional foundations of liberty and equality.

4.1. The natural state

All states must control the fundamental problem of violence. In limited access orders or natural states, a dominant coalition of the powerful emerges to solve this problem. The coalition grants members privileges and creates rents through limited access, that is, by limiting access to valuable resources and organisations. The purpose of generating rents and privileges is that they allow the coalition to sustain order. Because fighting reduces their rents, coalition members receiving sufficient rents have incentives not to fight so as to maintain their privileges. Natural states necessarily limit access to organisations and restrict competition in all systems, economic, political, and social. Failing to do so dissipates rents and therefore reduces the incentives not to fight. We call this order the natural state because for nearly all of the last 10,000 years of human history – indeed, until just the last two centuries – the natural state was the only solution to the problem of violence that produced a hierarchical society with significant wealth.

The NWW framework redefines the process of economic and political development as the transition from a limited access order to an open access order. The transition is a difficult process, and NWW argue that only two or two and a half dozen states have successfully completed it.

Some natural states move into positions in which a series of changes towards open access can be sustained. Within a limited access order, conditions may arise that enable impersonal relationship to develop among elites. When this occurs, elites may find it in their interests to institutionalise these relationships.

NWW divides the transition from natural states to open access orders into two parts, the DCs and the transition proper. There are three DCs:

4.1.1. DC 1: rule of law for elites

Some natural states institutionalise relations among elites so that privileges are regularised in a way that they transform into elite rights; put another way, privileges move from being personal and idiosyncratic to being impersonally applied equally to all elites. English medieval land law provides an illustration (see NWW ch 4 for details). In the eleventh century, land rights were personal; they depended on, inter alia, the relationship of the landholder to the king. In particular, the right to land reverted back to the king on the death of the lord. For a negotiated payment – depending on the value of the land, on the expected relative power of the heir, and on other political and economic conditions – the heir could continue to possess the land. The king treated each such transaction differently; hence, rights in land were personal. Over time, this process became standardised and impersonalised in fees. As another example, competition among different court systems in England for revenues led courts to innovate, leading to rules that better served elite interests (Klerman & Mahoney, 2005). Importantly, legal rules emerged granting landowners the right to control how land passed among various heirs when they died, including the ability to grant rights to land on conditions (whereby if the conditions failed, the land reverted to another heir).

Cox et al. (2015) use a bargaining model to formalise these statements about ‘sufficient rents’ to prevent violence.
4.1.2. DC 2: perpetually-lived public and private organisations
All natural states are mortal in the sense that, as the dominant coalition and rulers change, so too do fundamental aspects of the state, such as the rules governing political choice and a range of privileges. Chavez in Venezuela, Putin in Russia, Mao in China all unilaterally changed constitutional arrangements when they took power. In each case, many private organisations disappeared as the membership in the dominant coalition changed. Natural states have limited ability to make credible commitments to honour various rights and rules that bind successor coalitions and leaders, so that new leaders often make dramatic revisions in the nature of institutions, rights, and policies. The idea of perpetuity is that the fundamental features of the state extend beyond the lives of the current officeholders and their support coalitions so that the public institutions and the rules governing politics and economics do not depend upon the identity of the officials that hold them.9

4.1.3. DC 3: consolidated political control over violence and the military
The third DC is at once the most difficult to understand and to achieve. Without consolidated, political control over the varied sources of violence, including the military, neither of the other DCs can hold. Neither the rule of law nor credible commitments supplying perpetuity can exist as long as one faction can use force to bend others to their will. Few discussions of the rule of law mention this problem (Weingast, 2010). And yet, as critical as this condition is, we know too little about how this consolidation takes place (NWW, 2009, Ch. 5).

4.2. Implications of the emergence of liberty and equality
Liberty and equality emerge along with the DCs and, more generally, during the transition. The first DC, rule of law for the elite, implies a solution to the problem of arbitrary power of the predatory state. Rule of law also implies equality before the law. Liberty qua the rule of law implies impersonality. The rules do not depend on the identity of the people involved. Impersonality provides general rules that apply to wide classes of citizens. Further, for the rule of law to be sustained, political officials must have incentives to honour it. As noted, the second DC, the perpetual state, also requires institutions to provide new political officials from arbitrarily changing the rules of the game once in power. My study with North, arguing that the English constitution following the Glorious Revolution provided credible commitments, can be interpreted as creating a perpetually lived state (North & Weingast, 1989).

In short, the contention that liberty and equality can exist apart from institutions is problematic. But if liberty and equality require forms of credible commitments to be sustained, how do they work?

5. Why 1800? – or, Ideas redux: how early modern political-economic theorists came to understand and build institutions that could sustain liberty and equality
For liberty and equality to have an effect, they must move from the realm of ideals into the realm of action. How did this transformation take place in practice? Drawing on my work in progress with Josiah Ober, I briefly sketch the argument of how various political theorists devised an answer to this question in the 150 years prior to 1800. Of necessity, this survey will be brief and inadequate; I nonetheless hope it will be sufficient to suggest the nature of the larger argument.

9An especially important aspect of perpetuity is the creation of perpetually lived organisations, ones whose existence extends beyond the lives of the individuals that create them. Partnerships, the dominant form of business organisation throughout history until the nineteenth century, require that the organisation be dissolved or reorganised on the death or voluntary leaving of one of the partners. These organisations do not, as a matter of course, live beyond their progenitors. Corporations with tradable shares and allow shareholders to pass their shares to heirs upon their deaths, creating perpetually lived organisations. Wholly apart from limited liability, perpetuity lowers the risk facing organisations.
5.1. The emergence of a solution to the problem of arbitrary power

In the mid-seventeenth century, no one understood how to create a stable alternative to an authoritarian regime. Yet, by the end of the eighteenth century, early modern political theorists had produced a modern ‘science of politics’ explaining how such a regime could be sustained in theory. Further, Madison and the American founders had put these ideas into practice with the design and ratification of the U.S. Constitution.

These theorists lived in much nastier worlds than we do, not in nice developed, open access orders but in violent natural states where people might be killed for what they said or believed, or just because they had something of value that others could take. These theorists were deeply interested in how their societies worked, including what accounted for bad behaviour by government. Important components of their normative theories focused on how to solve the problems of their states as they defined them.

One of the principal questions animating these theorists was whether it was possible to sustain a form of government in alternative to an absolute monarchy, not just in conception, but implemented and sustained in practice for multiple generations (see Kalyvas & Katznelson, 2008, pp. 5–6).

In Leviathan (1651), Hobbes answered these principal questions with an emphatic ‘no!’ He famously argued that ‘a Kingdome divided in it selfe cannot stand’ (Hobbes, 1651/1991, II, 17, p. 127). Dividing governmental powers to create a republic inevitably led to civil war and disorder. The only stable form of government, therefore, was an absolute monarchy. As proof, he adduced the political violence of the recent English Civil War (1641–1649).10

Ober and I agree with Hobbes in the sense that, in 1651, no one knew how to design and sustain a stable alternative form of government to the absolute monarchies of the era, governments that protected people from arbitrary power and that fostered market economies. Ober and Weingast (2016) reformulate Hobbes’s assertion as Hobbes’ Challenge. The challenge, implicit in Hobbes’s arguments, asserts that, for an alternative form of government to be credible, it must be more than normatively attractive; it must also explain how the proposed form of government can be implemented and sustained.

We mean something quite specific by ‘implemented and sustained,’ viz., a government that is self-enforcing in the sense that no actor has an incentive to violate the rules (see Acemoglu & Robinson, 2006; Greif, 2006; Myerson, 2009; Weingast, 1997). Political officials must have incentives to adhere to the rules; and those out of power must have incentives to eschew using force to take over the government.

Early modern political theorists understood the point about self-enforcing institutions. Hobbes, for example, argued that ‘Covenants, without the Sword, are but Words, and of no strength to secure a man’ (Leviathan II, p. 17, p. 117). Harrington (1656, pp. 30–31) presaged the idea that the government must be a Nash equilibrium,

that the perfection of government lieth upon such a libration in the frame of it, that no man or men, in or under it, can have the interest or, having the interest, can have the power to disturb it with sedition.

Hume (1739–1740, p. 344) explains that, as

it’s impossible to change or correct any thing material in our nature, the utmost we can do is to change our circumstances and situation, and render the observance of the laws of justice our nearest interests, and their violation our most remote.11

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10If there had not first been an opinion received of the greatest part of England, that these Powers were divided between the King and the Lords, and the House of Commons, the people had never been divided, and fallen into this Civill Warre’ (Hobbes, 1651/1991, II, 17, p. 127).

11Hume continues:

Here then is the origin of civil government and allegiance. Men … cannot change their natures. All they can do is to change their situation, and render the observance of justice the immediate interests of some particular persons, and its violation their more remote. These persons, then, are not only induc’d to observe those rules in their own conduct, but also to constrain others to a like regularity, and enforce the dictates of equity thro’ the whole society. (p. 344)
According to James Madison (Federalist 51),

if angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself.\textsuperscript{12}

\section*{5.2. Elements of the system}

During the debates about constitutions over the years 1650–1800, a range of institutions emerged as central to control of the government so that political officials would have incentives to honour restrictions on power, including liberty and equality. One of the major problems that animated early modern theorists, including Hobbes and Locke and Smith and Madison, involved the arbitrary power of government, called ‘grand coups d’authorité’ by Montesquieu. In modern technical terms, the issue is executive moral hazard (see Besley, 2006) or government predation. Labels aside, could this problem be solved?

In this brief survey, I present two mechanisms studied by early modern political theorists designed to provide incentives for the executive to eschew arbitrary actions. Consider first the issue of dividing power, as in the well-known separation of powers system. Locke, Montesquieu, Smith, and Madison all emphasised this approach. Montesquieu states the principal problem to be solved:

> When legislative power is united with executive power in a single person or in a single body of the magistracy, there is no liberty, because one can fear that the same monarch or senate that makes tyrannical laws will execute them tyrannically. (Montesquieu, 1748, II.11.6, p. 157)

Similarly, judging must be separate from executive power. ‘If [judging] were joined to the legislative power, the power over the life and liberty of the citizens would be arbitrary, for the judge would be the legislator’ (p. 157). The executive also needs protection from the legislative branch:

> ‘if the executive power does not have the right to check the enterprises of the legislative body, the latter will be despotic, for it will wipe out all the other powers, since it will be able to give to itself all the power it can imagine.’ (Montesquieu, 1748, II.11.6, p. 162)

Without veto power, the executive ‘will soon be stripped of its prerogatives’ (Montesquieu, 1748, II.11.6, p. 164).

Montesquieu concludes: ‘So that one cannot abuse power, power much check power by the arrangement of things’ (Montesquieu, 1748, II.11.4, p. 155). Madison’s famous argument in Federalist 51 echoes Montesquieu: ‘Ambition must be made to counteract ambition.’ Madison expressed the idea of dividing power in F51, [T]he constant aim is to divide and arrange the several offices in such a manner as that each may be a check on the other – that the private interests of every individual may be a sentinel over the public rights.\textsuperscript{13}

The advantage of this dividing power is that the different components of the government have incentives to monitor each others’ behaviour and to react against violations of the prescribed rules. In Adam Smith’s words,

> If therefore the severall parts of the government have a perfect right to their severall provinces, it must be supposed that they are intitled to defend themselves in them by force. – If therefore the king levies taxes which are not imposed by Parliament, he breaks the rules of the government. This was what James 2d did [leading to the Glorious Revolution of 1688]. (Lectures on Jurisprudence, pp. 326–327)

The second mechanism raised here as helping sustain a constitution is the right of resistance. This idea embodied the right of the people to act against a government that failed to act in the people’s

\textsuperscript{12}This point is recognised in the secondary literature: Phillipson (2010, p. 104), for example, argues that Smith and ‘other Scots admired ... Montesquieu’s method, his typology of the different forms of government known to history, [and] his analysis of the conditions on which their survival depended.’

\textsuperscript{13}Other balancing institutions in the U.S. Constitution include: bicameralism or balancing the Senate against the House of Representatives; granting states direct representation in the national government through the Senate; and elections and representation. The vertical separation of powers – that is, federalism – constituted another (and too often, overlooked) means of dividing power and creating mutual monitors; and the Senate veto over major executive branch appointments.
interest. Locke held that the ruler or prince had an obligation to act in the people’s interest. When the ruler failed to do so— for example, by usurping power from one of the other components of government—he is considered to have ‘dissolved’ the government. And,

\[
\text{when the government is dissolved, the people are at liberty to provide for themselves, by erecting a new legislative, differing from the other, by the change of persons, or form, or both, as they shall find it most for their safety and good. (Locke, 1689, p. 110, §220)}
\]

By reacting in concert— that is, by coordinating— the people could threaten the executive, forcing it to back down or leave office.\(^{14}\) Montesquieu, Smith, and Madison all addressed this issue. Importantly, Madison and the founders discussed the right of resistance mechanism in greatest detail.\(^ {15}\) Consider paragraph 3 of the Declaration of Independence (1776). Echoing Locke quoted above, the founders wrote:

\[
\text{We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness. – That to secure these rights, Governments are instituted among Men, deriving their just powers from the consent of the governed, – That whenever any Form of Government becomes destructive of these ends, it is the Right of the People to alter or to abolish it, and to institute new Government.}
\]

In this paragraph, the American founders embed liberty and equality and other values in the context of the right of resistance. Violations of liberty and equality held the threat of violent reactions, thereby making them less likely.


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\text{Anti-Federalists thought that … [w]ithout a bill of rights, the people would never know when the government had exceeded its just powers; they would therefore find themselves unable to resist its pretensions, because they would have no fixed standard against which to measure its acts. If a bill of rights was a command to anyone, then, it was directed to the citizens themselves, not their government.}
\]

On the positive side of preventing constitutional violations by the national government, political officials in the states had an important role. Madison and Hamilton both express the incentives of citizen reaction in the face of government transgressions: ‘But what degree of madness could ever drive the federal government to such an extremity?’ (F46, p. 307). The

\[
\text{state legislatures, who will always be not only vigilant, but suspicious and jealous guardians of the rights of the citizens against encroachments from the federal government, will constantly have their attention awake to the conduct of the national rulers, and will be ready enough, if any thing improper appears, to sound the alarm to the people, and not only to be the VOICE, but if necessary, the ARM of their discontent. (F26, pp. 163–164, emphasis in original)}
\]

In short, a range of ideas emerged over the period prior to 1800 about how to implement a government that could sustain liberty and equality. Importantly, these ideas were put into practice, first in the Dutch Republic in the seventeenth century, England during the Glorious Revolution, and then in the United States with its new Constitution.

6. Conclusions

Too often ignored and misunderstood, liberty and equality are ideas critical to understanding economic and political development in general and of the great enrichment in particular. Embodied and

\(^{14}\) provide a theoretical understanding of this mechanism in Weingast (1997).

\(^{15}\) Adam Smith argued that a clear understanding of the division of powers is essential to fostering citizen coordination.

With regard to governments where the supreme power is divided amongst different persons, there is no great difficulty in ascertaining when any one transgresses the limits of his power. There could be no doubt at the [Glorious] Revolution that the king had exceeded the limitis of his power. (Smith, Lectures on Jurisprudence, p. 325).
implemented through institutions, liberty and equality produce the Smithian sources of economic growth, that is, the division of labour and capital accumulation. Taken together, these two ideas foster creativity by rewarding people for solving problems; they also foster an explosion of competition, participation, talent, and creativity in both politics and economics. This explosion extends far beyond a narrow elite to include a much more extensive pool of talent. As McCloskey explains, in the centuries prior to 1800, liberty and equality expanded in Western Europe, first applied to a small elite, then to a larger elite, and finally, to a much larger group. "Think of the Magna Carta for all barons and charters for all citizens of a city, and finally "all men are created equal"" (McCloskey, 2016a, p. 8).

The effects of liberty and equality are latent in natural states. They become manifest in states characterised by the DCs and the transition proper. Elements of open access orders implied that, "For the first time, thank God, … the ordinary people, the commoners, both workers and bosses, began to be released from the ancient notion of hierarchy, the naturalisation of the noble gentleman’s rule over hoi polloi" (McCloskey, 2016a, p. 10).

The neoclassical fallacy holds that markets exist independent of political institutions that provide market infrastructure, such as secure property rights, contract enforcement, and the rule of law. Economists nonetheless often implicitly assume these characteristics, suggesting that they implicitly recognise the importance of liberty and equality. Indeed, one of the ‘economic roles of political institutions’ is to ensure that these values hold (Weingast, 1995). Put another way, liberty and equality are part of the infrastructure necessary to sustain markets, and every model that assumes perfectly competitive markets also assumes liberty and equality.

Early modern political-economists of development focused on the problem of market infrastructure in the form of preventing the arbitrary abuse of power, a problem that stood in opposition to the rule of law, of liberty and equality. The idea of government predation used in the modern political economy literature approximates the earlier notion of arbitrary power. I have noted above Adam Smith’s view of the absence of growth under feudalism. Reflecting the natural state logic described in Section 4, no one could keep the peace. Kings were insufficiently powerful to enforce their authority, law, and order throughout their domain. The result was violence and disorder. The great lords ‘were always at war with each other and often with the king, their whole power depended on the service of their retainers and tenants’ (Lectures on Jurisprudence, p. 249). Speaking of the great lords, Smith says: ‘Their lawless and freebooting manner of life also’ precluded many forms of commerce and long-distance trade (Lectures on Jurisprudence, p. 248). Put simply, plunder inhibited economic development. Saving was difficult, and individuals who could hoard money had to keep it hidden or risk plunder.

Turning to the larger lessons for the great enrichment, we are nowhere near a causal explanation of the great enrichment. Many of the hypotheses McCloskey rejects are important necessary components of the great enrichment even if none alone are sufficient to explain it. There is a rhetorical tendency for the proponent of a new idea to claim their idea is ‘the’ idea rather than an essential piece of the puzzle. North and I are guilty of this tendency in our focus on institutions and credible commitments in the English constitution (North & Weingast, 1989). So too, it seems, is McCloskey.

As noted at the outset, McCloskey’s thesis can be interpreted in two ways, a strong form and a weak form. The strong form holds that liberty and equality are the sole elements necessary and sufficient for the great enrichment. The logic just discussed explains why I disagree with a strong form of the McCloskey hypothesis. In contrast, I agree with a weak form of McCloskey’s thesis; liberty and equality are essential necessary components of an explanation for the great enrichment; and, further, students of development and the great enrichment have failed to see the critical role of these ideas.

I have emphasised throughout that the ideas of liberty and equality must be implemented in the realm of action. This requires a range of institutions to support liberty and equality. To be sustained liberty and equality must be self-enforcing in the sense that political officials have incentives to adhere to the prescriptions of these ideas. This intertwining of ideas and institutions surrounding liberty and equality makes it difficult to say that ideas alone, in the absence of institutions, explain
the great enrichment. Likewise, institutions alone are insufficient to understanding the great enrichment.

A final question about the great enrichment is, why 1800, not 1760, 1832, or 1850? I propose an answer to this question involving an argument about ideas that complements McCloskey’s. The discussion in the previous section parallels McCloskey’s discussion of the development and growing appeal of liberty and equality, especially in the sixteenth to eighteenth centuries.

In 1651 when Hobbes wrote *Leviathan*, no one knew how to sustain a government that could support liberty and equality. Hobbes understood this when he argued that the only form of government that could sustain order and prevent violence was an absolute monarchy.

Over the following 150 years, political theorists relying in part on evolving practice and in part of evolving theories slowly figured out how to devise a government that could sustain liberty and equality and prevent arbitrary abuses of power. These goals were embodied in seventeenth-century Dutch Republic, the post-Glorious Revolution English constitution for an elite and, a century later, for all white men in the U.S. Constitution. At the same time, political theorists following Hobbes devised a new ‘science of politics’ – a phrase used by Hume, Montesquieu, and Madison – to articulate the principles underlying these constitutions.

Per McCloskey, ideas matter. McCloskey’s (2016a, 2016b) paper and larger work help focus our attention on the link between the abstract realm of ideals and the everyday world of action and pragmatics, a point I have amplified above. Liberty and equality are essential to understanding modern markets, political-economic development, and the great enrichment. Ironically, the neoclassical fallacy suggests that economics has long had a role for liberty and equality, though implicitly and without acknowledgement or understanding. McCloskey’s work brings these ideas to the fore, forcing us to confront their role, meaning, and embodiment in practice.

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