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**Are Property Rights Relevant for Development Economics?  
On the Dangers of Western Constructivism**

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# **Are Property Rights Relevant for Development Economics?**

## **On the Dangers of Western Constructivism**

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### **Abstract.**

Although the importance of property rights as the engine of growth remains beyond dispute, this article tries to show that the crucial issue is not so much the definition of the allegedly ‘optimal’ property right system, as the understanding of the ideological elements that justify property rights in the first place – entrepreneurship and self-responsibility. Unless one clearly perceives the nature of the ideological structure that legitimises the rules of the game in a given society, it is virtually impossible to understand why growth-conducive property-right systems fail to emerge and be accepted.

Put differently, property rights are certainly necessary for growth. But they are no tools for policy-making. Getting them right – or transferring them from other contexts - is not enough, especially if their assignment and enforcement remains a top-down process, whereby local politicians or international technocrats suggest and enforce institutional arrangements experienced elsewhere.

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## **On the notion of economics**

Modern economic analysis is usually conceived in two different ways. Some believe that economists should study how given policy goals can be attained. In particular, when mutually inconsistent objectives are proposed, social scientists should describe the implicit trade-offs and suggest solutions, possibly by referring to targets of a higher order. The main actors are thus the policy maker, who defines the objectives, and the social engineer, who designs the course of action consistent with the assigned target.

Contrary to this widely shared (mainstream) view, the subjectivist school claims that all social sciences should be dealing with the way individuals behave and interact in order to pursue their own aspirations. The search for a social goal should thus be ignored, for it would necessarily be based on arbitrary utilitarian hypotheses, thereby leading to useless or even harmful results. In particular, (free-market) economists should focus on the analysis of human conduct in the presence of scarcity constraints, whereby individuals have to choose what to sacrifice in order to meet their preferences or - more precisely - to increase their satisfaction.

The differences between these two views have important consequences from the moral, positive and normative standpoints. They also define the different roles of property rights within the context of growth and development. The first part of this work is thus devoted to recalling the ethical validation of a society based on private property rights principles and draws some implications for growth and development policies from a free-market perspective. By contrast, the second part focuses on the discretionary nature of the property rights systems associated with the orthodox views, be such views a matter of central planning or of technocratic design. Although the importance of property rights as the engine of growth remains beyond dispute, most of this article tries to show that the crucial issue is not so much the definition of the allegedly 'optimal' property right system, as the understanding of the ideological elements that justify property rights in the first place. Thus, unless one clearly perceives the nature of the ideological structure that legitimises the rules of the game in a given society, it is virtually impossible to understand why growth-conducive property right systems fail to emerge and be accepted. Put differently, property rights are certainly necessary for growth. However, getting them right is not enough.

## **Morality, rules and policy-making in free-market economics**

Morality is probably the key concept. It is usually understood as a set of behavioural rules consistent with the ethical standards shared by the large majority of the individuals forming a community. Therefore, morality changes over time and across communities and defines the patterns of social cooperation<sup>1</sup>. For instance, today torture or capital punishment are morally unacceptable by most people in Western Europe, but under given circumstances they are deemed appropriate in other parts of the world. Similarly, in many countries breach of contract on the workplace is often standard practice if committed by the employee, but it becomes immoral if committed by the employer. Tolerance with respect to theft or fraud is also highly variable across countries and across time.

Indeed, one can probably maintain that such sets of shared subjective values define the communities themselves. From a historical perspective, that was actually the case in much of Europe for a very long time – say, at least until the XVIth century. Until then, individuals were first of all Christians (and also Orthodox, Catholics, Reformed), Muslims, Pagans, Jews, etc. Political boundaries were porous and had little to do with national belonging, fatherland and special bonds to countrymen. Loyalty to a ruler was based on the prevailing Christian morality, which prescribed little more than vague obedience to an élite designated by divine power to administer justice and possibly provide protection against external attacks, too<sup>2</sup>.

It is manifest that this approach to morality does not imply any obligation for the individual, who should then be free to pursue his own preferences as long as he does not opt for violence<sup>3</sup> in order to limit other people's freedom to choose. Of course, agents

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<sup>1</sup> Of related interest are the notions of fairness and justice, which differ according to the legitimacy of the action involved. In the Judaeo-Christian tradition 'just' (i.e. legitimate) denotes an action that respects the fundamental principle of equal human dignity, which can be considered as a synonymous of individual freedom. On the other hand, fairness reflects the individual evaluation of others' behaviour, which can be approved or disapproved irrespective of its legitimacy. Unfortunately, the distinction between fairness and justice has become blurred in modern democracies, where the notion of 'legitimate' has been replaced by the concept of 'legal'; legal now being what the majority believes to be fair.

<sup>2</sup> Many authors, from the XVIIth century (Hobbes) until today (Buchanan and Tullock 1962) have tried to develop the notion of 'social contract'. All their efforts, however, shared the same purpose, i.e. to replace a divine contract with a secular one. As underscored in Hoppe (2001), they all ended up by offering a reason for the monopoly of state power to exercise violence and by justifying the very existence of the state in the absence of divine legitimacy.

<sup>3</sup> That includes both physical and non physical violence (e.g. fraud and deception).

do not necessarily operate in a society without rules. But such rules do not need a forced-upon, pre-defined moral framework<sup>4</sup>. On the other hand, they require compliance with the principles of human dignity, which cannot be separated from the notion of private property rights; and from man's right to subdue nature. These are at the core of what is usually known as Western Culture. Hence, the sacredness of individual freedom, the duty to accept individual responsibility and the inviolability of property rights both over the fruits of one's own labour and efforts and over natural resources not previously appropriated by others. Given these fundamentals, which are rooted in the so-called natural law, all other rules that discipline human action should be the result of an explicit contract, whereby individuals voluntarily accept to restrict their behaviour, if they wish to do so.

Contrary to the orthodox approach, where morality is a set of collective goals defined through a process of democratic selection, the moral fundamentals of free-market economics set severe limits to political action, since in this latter case the politician cannot interfere with individual liberty and property rights. He can only protect and enforce them; and loses legitimacy when his behaviour is at odds with the natural order<sup>5</sup>.

One can thus conclude that the issues of development and growth<sup>6</sup> in a free-market context in fact are non-issues, for development is hampered whenever the institutional framework restricts economic freedom. Similarly, growth is simply a matter of personal choice, for it reflects the desire to sacrifice leisure and engage in

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<sup>4</sup> This is an open issue among subjectivists. The Austrian School (Mises) suggests that one should not try to persuade another individual to accept moral standards other than those spontaneously developed by himself. By contrast, Economic Personalism maintains that non-violent calls for moral reform are perfectly legitimate, as long as private property is not questioned. See on this Beaulier and Prychitko (2001).

<sup>5</sup> See also Hoppe (this volume).

<sup>6</sup> Despite strong criticism by several Austrian economists (see for instance Rothbard 1963 and Batemarco 1987), the literature defines growth as an increase in aggregate purchasing power, as described by GDP and income statistics, with some adjustments. The term development may take two meanings. It can denote the improvement of a number of aggregate variables that reflect collective well-being, such as per capita GDP, life expectancy, literacy, health conditions, caloric intake, unemployment, infrastructure. Distribution of these variables across the population is also considered, so that homogeneity implicitly turns out to be another important element of development. However, the word 'development' can also denote the range of opportunities open to the individual, where the word 'opportunities' refers to the ability to satisfy preferences and the returns of one's own efforts and investments. The former definition is typical of the orthodox view and is usually described by the so-called 'Social Development Index' (United Nations/WHO), whereas the latter is typical of the free-market view and described by the 'Index of Economic Freedom' (Heritage Foundation).

productive activities, given the opportunities available. Surely, there is no need for growth strategies, development policies or grand projects of any kind, but only for an appreciation of the protection and enforcement of property rights in a given institutional framework (which is far from being an easy task, anyway).

Put differently, from the free-market standpoint an undeveloped country is one where property rights are not enforced. Per-capita GDP plays a role only because this variable is often correlated with the lack of economic freedom. Thus, it provides a clue as for where property rights are more likely to be violated. And inequalities play no role at all, either; unless they originate from arbitrary rules of the game being imposed upon various layers of the population according to religion, race, tribal origin, gender, passport, etc..

### **Property rights and orthodox development economics**

As hinted in the preceding paragraphs, the moral foundations of mainstream economics are not based on subjectivism. Instead, good or bad orthodox policies are defined according to their perceived ability to attain shared goals, rather than to enhance individual preferences. Not surprisingly, economists then turn to statistics, or devote their energies to studying political expediency and pragmatism, so as to develop recipes for effective policy making and methods to maximise consensus. Somewhat paradoxically, the repeated efforts to transform economics into a hard science have transformed many scholars into instruments serving a very soft discipline – politics in redistributive democracies. Property rights structures are thus a tool of policy-making. As a result, they become subject to political or technocratic discretion when it comes to their definition, their assignment or re-assignment, their enforcement. Mainstream development economics is no exception.

### *Substituting planning for private property rights*

Two distinct periods have characterised traditional post-WWII development economics<sup>7</sup>. The first coincided with widespread planning ambitions and dominated until the early Seventies, possibly a little longer. Despite the disappointing results of pervasive state intervention in the 1930s, both the academic community and public opinion were impressed by the alleged economic successes of the Soviet bloc and eager to reproduce at least some features of the central-planning process. In particular, private property would be accepted, but considered to be subject to aims and principles of a higher order. Even today, the same principle would apply to situations where individuals exchanging property rights are not able or willing to take into account the full implication of their decisions. Of course, this falls short of perfection and can be interpreted as an economic inefficiency. But since this is always the case in any human activity, assessing when such inefficiencies are intolerable has become a matter of discretionary evaluation by the policy-maker, the legislator, the judiciary.

The undeveloped world turned out to be an almost ideal target for greenfield experiments in economic policy. In some cases development economics focused on how property rights were to be re-defined and transferred to the state, i.e. to politicians and various layers of the bureaucracy. In other cases property rights were weakened and made subject to arbitrary intervention by the state, rather than transferred. By and large, however, the assignment, exchange and enforcement of property rights were designed in order to suit political priorities, rather than individual economic needs and preferences.

Not surprisingly, all efforts to reproduce Western or even Soviet economic results failed miserably. In most cases, centralised investment policies and easy credit led to cathedrals in the desert, capital outflows and ultimately heavy debt. Similarly, educational policies led to elite schools for the top politicians, bureaucrats and their

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<sup>7</sup> The birth of development economics coincides with the downfall of the Western colonial empires and the ascent of the role played by the mass media. In particular, economic events in many former colonies became of international political interest, Western politicians and bureaucrats perceived new opportunities to satisfy their quest for power, honours and prestige, Western public opinion became more exposed to the many tragedies taking place in previously unknown parts of the world.

clients<sup>8</sup>. Whereas technological transfer actually meant well-remunerated jobs for international professionals and bureaucrats, to be paid by international agencies.

Surely, property rights were not entirely destroyed. The tragedy of the commons as traditionally understood was not necessarily a distinctive feature of the undeveloped areas. Rather, rights were *de facto* appropriated by the political class and subsequently reassigned, sometimes for limited periods of time, sometimes with no guarantee of enforcement. In many situations this explains the frequent outbreaks of violence, as competing pressure groups tried to appropriate and enforce rights on the resources; or to influence their assignment by the political élites and thus acquire some kind of legitimacy *vis-à-vis* third parties, including the international community.

#### *From planning to technocratic utopia*

Different editions of the neoclassical paradigm have dominated the second period of orthodox development economics. They all tried to provide explanations for the failures of the previous decades and they all shared the view that property-right assignments were a matter of technocratic intervention. According to a naive version, economic backwardness was attributed to bad policy-making, due to poorly qualified decision-makers. Consistent with this view, most recipes aimed at (i) providing expert economic advice and/or a justification to carry out allegedly good economic policy even if resisted by public opinion<sup>9</sup>, (ii) offering financial support in order to enhance political feasibility, i.e. to reduce the cost of transforming a rent-seeking society into a free-market economy, (iii) providing financing and know-how so as to realize adequate infrastructure and public goods, without which a market economy cannot work properly, (iv) introducing democratic political institutions. These measures have not made a great difference to the economies of the undeveloped world. Most of them remained poor. Indeed, many countries that did well in the 1970s and the 1980s followed other avenues and would hardly figure among the suitable case studies for neoclassical textbooks.

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<sup>8</sup> As recently argued by Carneiro and Heckman (2003), the quality of human capital depends more on the ability to provide motivation and enhance an adequate family environment, rather than on policies to favour education directly.

<sup>9</sup> This is generally known as the 'shield effect' (Vaubel, 1992), and is also typical of many developed countries, where it often protects bad policy makers from domestic criticism.



After having suffered from severe criticism, this naïve version has gradually been integrated by another set of prescriptions and has been gradually transformed into a new story, whereby the influence of the institutional school of thought is apparent. It argues that growth and development are indeed a matter of appropriate institutions (rules of the game), and that the quality of institutions ultimately depends on the definition, exchange and enforcement of property rights. Hence, new development policies are focused on the creation of a system of political rules and organisations that replicates - by and large - those currently in place in the developed world. The importance of property rights is now fully acknowledged. Still, its assignment and enforcement remains a top-down process, whereby a local politician or an international technocrat suggests and enforces the most suitable institutional arrangements<sup>10</sup>. As will be discussed at length shortly, this represents a crucial weakness and seriously undermines the traditional property-rights view of economic development.

#### *Where do we stand?*

There is little doubt that the institutional commitment shown by much of the orthodox economic profession is not going very far. Under these circumstances, private property is not the foundation of human dignity and societal interaction, but rather a tool for policy making. Indeed much of the debate in the recent past has concentrated on defining the extent to which (private) property can be violated, what kind of rules of the higher order are needed in order to limit discretion, how such rules can be enforced. Similarly, a considerable part of the ‘political economy’ literature has been devoted to explaining which constitutional project stands the best chances to reduce political instability, social tensions (if not civil war), misbehaviour and discretion by bureaucrats and policy-makers (e.g. corruption). Similarly, hundreds of experts spend their time in teaching the virtues of market economics and fair income distribution.

In fact, failures have been caused neither by ignorance about the virtues of property rights economics, nor by the boundless and brutal greed of shortsighted but rational autocrats with an interest in crushing opportunities for development. There is no doubt that the persistent failure to grow owes a great deal to poor rules of the game and

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<sup>10</sup> This is the essence of the of the so-called political economy approach, as opposed to the institutional school, which emphasises the importance of a bottom-up process. See for instance Pejovich (2003).

unsatisfactory property-right arrangements. But at least equally important is the interaction between deeply rooted informal institutions, old cultural traits, new and possibly disruptive ideological features. Enforcing property rights from outside will not do. For the outlook for growth will remain gloomy as long as the ability to create and seize opportunities for self-enhancement is being hampered. In other words, it is here maintained (1) that property rights cannot be imposed by fiat, (2) that in order to understand what kind of property rights structure is likely to develop and whether that is conducive to growth one must understand the dominant ideological features of a society and (3) that the ideological traits relevant for the birth of private property rights systems cum growth are entrepreneurship and self-responsibility. These should not be taken for granted too easily and will now be analysed in greater detail.

### **The origins of desirable evolutionary patterns**

Two key notions identify the origins of success in the fight among competing civilisations. They are the principles of entrepreneurship and of individual responsibility, upon which both geography and ideology have played important roles. In particular, growth depends on the willingness and ability of the individual to act, take responsibility for his own actions and possibly break new ground (entrepreneurial behaviour)<sup>11</sup>. Clearly specified and enforced property rights - private property rights in particular - are of course also necessary. But without entrepreneurship and self-responsibility property rights per se do not generate growth. An ideological or cultural environment hostile to individual responsibility means that individuals are reluctant both to develop new knowledge and to take advantage of their talents, irrespective of the potential for high monetary rewards. Furthermore, such an environment tends to discourage outsiders, who may indeed be willing to take responsibilities, but are afraid

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<sup>11</sup> See also Holcombe (2001). Self-responsibility and entrepreneurship are of course two different concepts. The former refers to the full recognition of the consequences of individual behaviour, while the latter refers to the ability to develop new ideas and possibly bear the risk of failure. This holds true when talking about the individual. Still, when analysing the behaviour of a community for an extended period of time, a social environment where entrepreneurship is frowned upon is not likely to encourage self-responsibility. For example, when envy-led behaviour turns out to be morally acceptable, entrepreneurship is likely to be devoted to redistributive (rent-seeking) activities, rather than to the creation of wealth. Thus, if one ignores the entrepreneurial nature of the rent-seekers, it is plausible to claim that the ethics of (productive) entrepreneurship and that of self-responsibility go together. This is indeed the view taken in this text, where the notions of entrepreneurship and self-responsibility in a social context are used almost interchangeably.

that free riders or rent-seekers would be morally justified in interfering, if not explicitly encouraged to do so. Stagnation and poverty are the obvious results.

By considering development also as a matter of individual responsibility one is then led to ask why some communities are bound to accept responsibilities more easily than others. Or why some societies just reject any form of responsibility, except for very limited ambits, like the family. This is where geography and ideology may play a significant role. Of course, there is no such thing as an optimal geographical setting, or an ideal moral standard. They are both highly variable concepts. Individuals move and look for suitable locations to develop and satisfy their aspirations, as the history of migrations shows. Potentially rich lands, such as today's USA or Argentina, have followed entirely different economic paths and generated further puzzles for economic determinism. Similarly, ideologies that may seem beneficial to growth under given circumstances turn out to be obsolete and even counterproductive in contexts where the notion of legitimacy is subject to interpretation and interference by special interest.

Accidents obviously play an important role, too. However, by looking at accidents through neo-institutional lenses one would not go very far, other than describing the different paths that can develop within a civilisation, as shown for instance by De Long and Shleifer (1992). As discussed elsewhere (2003), according to the new institutional school an accident is the starting point of a path-dependent process, whereby the rules of the game develop according to a mix of rent-seeking dynamics and technological events. Although it would be hard to deny this statement, this view ends up by explaining evolution by referring to unexplained accidents. That is hardly acceptable as a theory.

By building on the new-institutional notion of accident, however, modern development economics justifies the introduction of new property-right systems as some kind of favourable accident, after which new promising growth patterns can emerge, perhaps thanks to individual successful 'path-finders' that induce imitators to follow (Pejovich, 2003). Surely, the assignment and enforcement of property rights and - more generally - the legitimacy of ownership would enhance capital formation and be the clear solution to the development problem, as recently suggested, for instance, in De Soto (2000). But the very problem of development is to understand why the legitimacy

of private property tends not to be accepted, that is why the hoped-for accident is so unlikely to occur.

### *Demography and property rights*

As regards geography, its effects on growth seem to depend on the response to demographic pressure (North and Thomas, 1973) and the need and opportunity to trade (Bauer, 1991). Population growth is assumed to have promoted Western growth in different ways. Demographic pressure forced people to migrate towards less populated areas. Distance made it more difficult for the central authorities to control individuals and thus use violence in order to extract rents. As a result, private property rights were easier to protect against external interference and economic activity was encouraged. Furthermore, individuals living in wide-apart areas would be settled in territories featuring different geological and climatic conditions. This would generate comparative-advantages in agricultural productions and profitable trade opportunities, leading to higher living standards. Of course, these effects were considerably enhanced by the discovery of the New World, which also reduced the prospect of famines and malnutrition and therefore allowed further population growth. In turn, a larger population would increase both the potential returns to entrepreneurial innovation (stimulated by a larger market) and the probability that innovation actually takes place (higher number of thinking individuals)<sup>12</sup>.

True enough, many of these elements point to the need to remove legal rents as a precondition for growth, which is more or less equivalent to underscoring the need to preserve and protect private property rights. Indeed, rent-seeking situations would dissolve if those who bring to bear the legal monopoly of violence did not infringe upon private property rights.

Nevertheless, this avenue of investigation will not be pursued further. The role of demography is surely not denied. There is no doubt that densely populated areas are more vulnerable to the consequences of bad harvesting and famines and that the scarcity

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<sup>12</sup> See for instance Jones (1999), who also stressed the importance of enforcing intellectual property rights. Indeed, it is not by accident that these were explicitly recognised by legislators in the advanced countries of the time: in Venice as early as the XVth century, in the Low Countries and England about a hundred years later. It should be added, however, that the real target of the legislation to protect intellectual property were not so much free-riding producers, but the Guild system, that *de facto* regulated access to the exploitation and the production of innovation.

of good land may have been a frequent threat over long periods in the Middle Ages. But these phenomena cannot be seriously taken as a brake on innovation. Indeed, history provides plenty of examples where demography has hardly been a problem for development. On the other hand, it is true that larger markets encourage producers to develop new technologies and reorganise factors so as to satisfy greater demand. Still, although the number of potential beneficiaries has certainly influenced the features of entrepreneurial activities, these numbers hardly had an impact on whether to engage in entrepreneurial activity or not. Transaction costs (transportation), trade policies and, more generally, the ability to appropriate the return to entrepreneurship were probably far more important.

Similarly, a clearly-defined property right structure is definitely preferable to regime of arbitrariness, violence and deceit. Its importance for growth is not denied. However, as already mentioned in previous paragraphs, this does not imply that property rights are a sufficient requirement for economic growth to take place. Nor does it imply that there must be some kind of institutional, top-down intervention so as to define and assign allegedly welfare-maximising rights. Once again, history provides plenty of examples of communities where property rights were fairly clear, where the state played a relative minor role, and yet economic development was virtually nil.

In a nutshell, searching for appropriate (optimal) property-right structures - including regulation - as recipes for development does not take very far, and can actually cause considerable harm. More important is the task of identifying the historical periods when property rights became important; of understanding why fairly similar property right structures and principles for legitimacy led to growth in some situations, while they remained more or less irrelevant under different contexts. A good part of the answer comes from trade.

### *Trade*

In ancient times populations that settled in coastal areas and were subject to demographic pressure could expand inland. Or they could trade, either with their neighbours, or with overseas populations. In many cases the first option was viable: coastal populations actually migrated and merged more or less peacefully with inland communities. In other situations sea trade was preferred and contributed to the birth of

economic systems based on exchange, specialisation. These economies relied heavily on responsible individuals, who were willing to take risks and were fully legitimised when making significant profits out of their activity.

By contrast, land proximity meant that comparative advantages offered relatively modest rewards to local trade. Exchanges were definitely smaller in quantity and entrepreneurship of less importance. The relatively high cost of land transportation also induced merchants to trade rather precious and easy-to move goods (gold, silver and slaves, for instance). These features probably conveyed the impression that trade was to the benefit of the élites only (landowners), rather than of the population at large. Hence, entrepreneurs were likely to be less appreciated from a moral viewpoint and the wealth of the merchants had not the same legitimacy as that of the warriors (reward to valour and courage) or - later on - of the aristocracy (honour and, perhaps more questionably, divine will). This difference made envy and expropriation more easily acceptable. If so, it is apparent that private property was bound to be increasingly vulnerable.

In short, before the rise of the so-called Western Civilisation, which more or less coincided with the downfall of feudal society, entrepreneurship had an opportunity to develop only under rather particular circumstances (sea trading communities). These could however easily break down under foreign attack and disappear<sup>13</sup>. And even when foreign aggression was repelled, more and more resources (and power) had to be devoted to a central authority responsible for defence. As a consequence, feelings of national, ethnic or even class loyalty became crucial to enhance collective security. When collective security and the absence of domestic tensions mattered, the notion of self-responsibility turned out to be a privilege, rather than a right. As such, it frequently became a prerogative of the recognised rent-seeking classes, i.e. of those who were (and

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<sup>13</sup> The idea of an invader with a long-term horizon, and therefore interested in enhancing the wealth of the occupied territories, does not apply to ancient times for two reasons. First, looting and enslavement was the only way for the ruler to remunerate his army and satisfy his clientele. Failure to do so would have been more or less the same as losing power. In addition, the ruler's legitimacy was often questionable. In the best case the ruler was supposed to enjoy the favour of the Gods, as witnessed by the various signals to that effect that the Gods were to shower on the population. The incumbent ruler was however made vulnerable by the godly signals his competitors might claim to their advantage. Surely, polytheism did not contribute to simplify matters. Christendom eventually solved both problems. God-to-man communication would have one source only (monotheism) and one receiver (or authorised interpreter - the Church).

are) less prone to develop productive entrepreneurial skills. As a result, entrepreneurship in the pre-Christian history was in very short supply (and demand).

When comparing the lack of development in the ancient world<sup>14</sup> with today's undeveloped countries, at least a couple of elements seem to deserve attention. First, in ancient times entrepreneurship was generally constrained by the difficulties to develop large-scale mercantile societies and by the critical attitude towards self-responsibility – a potential threat to social cohesion and defence capabilities. The role of property rights for development could thus be only marginal. In modern undeveloped countries large-scale entrepreneurship is also discouraged, for it represents a threat to the ruling élites. In particular, trade is allowed only locally, whereas those who want to engage in long-distance transactions are more or less obliged to fall prey of state-run or state-controlled intermediaries. As consequence, trade fails to develop and producers miss all the information that goes with it<sup>15</sup>: about new products, undetected needs, unknown promising markets, new technologies and equipment. Producers who are indeed successful beyond the local boundaries are those who have come to compromise with the state agencies. Hence the very notion of entrepreneurship is undermined, for success tends to be regarded as the result of privilege, rather than of entrepreneurial talent. Once again, the lack of secure property (private) rights is the consequence, rather than the cause.

One might thus conclude that in ancient societies mercantile economies failed to develop because of the short-term horizon of the rulers, and because of high transaction costs (transportation), which made it difficult to reap the advantages of specialisation. It would also be tempting to add that since today the latter costs are a fraction of what they used to be, the introduction of democracy and the elimination of rent-seeking autocrats would be sufficient conditions to revive entrepreneurship, since it would automatically lead to adequate property right structures (rule of law). Although presented in slightly

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<sup>14</sup> For the purpose of this paper, 'pre-Christian history' and the 'ancient world' extends approximately until the XIIIth century, when the new religion ceased to affect vast layers of the population and productive entrepreneurship in Western Europe spread with sizeable results.

<sup>15</sup> As underlined in Bauer (1991), trade is the engine of entrepreneurship, for it enhances the transfer of knowledge and creates opportunities for new ventures.

different terms, this is actually the core of most current development policies. Unfortunately, this conclusion misses the point and runs against facts<sup>16</sup>.

*Politicisation and lack of responsibility instead of property rights*

Indeed, the difference between the undeveloped world and the beginning of Western economic growth is not just a matter of lower transportation cost and a huge in expansion in the technology frontier attainable. Today's societies are also featuring a much higher degree of politicisation and democratisation. As forcefully explained in Bauer (1991) and Hoppe (2001), politicisation implies that an increasingly large number of individuals believe that the solution to poverty has to be provided by the political context (better constitutional rules, better policy-making, fair property-right rules); rather than by the creation of a suitable entrepreneurial environment that allows individual to strive in order to enhance their own welfare<sup>17</sup>. Politicisation is of course attractive, for it offers ready-made solutions, and diverts attention from the painstaking analysis of the mechanisms that should lead to solutions. A recent example is provided by Serbia, where most intellectuals believed that the only cause for the country's backwardness was President Milosevic, so that by removing the tyrant the Serbian economy would blossom with no further action. Instead, the logics of democratic politicisation usually opens up the race to power. Sometimes candidates compete peacefully, especially when the median voter has a lot to lose (high income or wealth) and not much to gain (discretionary power is effectively limited or dispersed). In other cases competition leads to violence, when most of the population has little to lose and much to gain (the winning faction often enjoys virtually unlimited discretionary power). It is then hardly surprising that many countries prefer to avoid democratic rules, and go for illiberal autocracies, as long these can limit conflict and violence. Even at the

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<sup>16</sup> On the one hand, the correlation between political regimes and growth is tenuous at best. On the other, many autocrats are voted into power through fair elections, and often confirmed to power. In most cases opposition comes from other would-be autocrats, rather than by candidates offering democratic rule.

<sup>17</sup> That also includes decisions about investment in equipment and human capital. The presence of allegedly imperfect capital markets is hardly an issue, for local savings are often adequate to finance the investments required. History shows that Western Europe in the Middle Ages started to invest with no support from Venus or Mars. More recently Barro (1999) has shown that inequality in income distribution bears no effect on savings, which is to say that the propensity to save does not depend on income. As regards human capital, Carneiro and Heckman (2003) provide evidence showing that education depends on family ethics and the opportunities for talent to emerge and be rewarded; much less on government programs.



expense of growth. Despite common beliefs, the key to development then seems to be less politicisation and possibly less democracy, too. Singapore and Hong Kong would of course be fitting examples.

Another element is the role of self-responsibility. In ancient times this was not an issue for a large part of the population. It was more relevant for the free men and the élites, but did not lead to significant results, for such results became possible only when self-responsibility was accompanied by entrepreneurship<sup>18</sup>. Prior to that, self-responsibility for the middle-class free man was only applied to his interaction within the local community. The notion of self-responsibility was surely present, since individuals were supposed to behave in the interest of the community and were punished for not doing so. Similarly, they were responsible for complying with the agreements the community had established with other communities. But it is clear that the informal rules of the game in most of those societies were mainly ‘defensive’, in that they were aiming at consolidating the status quo as a guarantee for social cohesion, rather than at promoting talent and experimentation on a wide scale. Despite this weakness, however, the ancient world actually offered a somewhat more promising picture, compared with today’s low-income countries. For ancient societies did not dispute the principle of human dignity; they rather disputed the question of who could be defined ‘human’<sup>19</sup>. As a matter of fact, ancient society turned into Western Civilization (i.e. growth, from an economic viewpoint) when human dignity became a universal notion and entrepreneurship acquired moral recognition<sup>20</sup>.

On the other hand, in the last decades politicisation has weakened the notion of self-responsibility, both in the developed and the undeveloped world. And the notion of democracy has favoured the concept of coercive solidarity, which is taken as a duty for some, as a right for others. Hence, if one takes an optimistic view, one could claim that it will not take centuries to go from backwardness to economic progress: information and transportation costs are low, the technological knowledge available is astonishing,

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<sup>18</sup> Of course, the underlying assumption is that self-responsibility is a necessary condition to obtain (productive) entrepreneurship, but not sufficient.

<sup>19</sup> As a matter of fact, this side of the question did not disappear very quickly. As late as the XVIth century the Church never took a strong position against those who justified deportation and slavery by claiming that African blacks and South-American Indios had no soul, and that therefore the rights of human dignity did not apply to them.

<sup>20</sup> See also Sirico (2000).

imitation effects are likely to be sizeable. A more cautious approach would perhaps suggest that today's problem is not about widening and integrating a well-established subjectivist view of social interaction (as shown by the transition from the classical to the Western civilisations). Instead, it is about transforming hopes for utopian, third-way solutions - presumably provided by a new and better class of enlightened politicians - into greater consciousness of the rent-seeking implications of collective decision-making processes. Somewhat paradoxically, the chances for this to happen are greater in those areas where the influence of the welfare-state culture is weaker. From such a standpoint, one could actually go further and claim that Westernization is the most dangerous enemy to development, more so than autocratic political institutions or the lack of rule of law.

### *Ideology*

The previous pages have suggested that the development of effective property right structures depends on the notions of entrepreneurship and self-responsibility. Individuals' attitudes and states of mind heavily influence these concepts. Hence, the notions of economic progress and individual satisfaction cannot be fully understood unless the area of shared ideologies is properly investigated, i.e. unless the set of shared moral standards that provide legitimacy to human action is appreciated. One may certainly welcome all attempts to suggest a history of ideologies, which is actually equivalent to suggesting a history of the dynamics of a civilization. Among others, Spengler, Toynbee, Hicks and Quigley are celebrated examples. Unfortunately, if one abandons the safe avenues of description, the risk of falling into the traps of social determinism is almost unavoidable.

By contrast, a more fruitful approach consists of looking at the source of ideologies, studying how the legitimacy of individual action is determined, how it evolves, and under which circumstances the existing principles of legitimacy can be replaced by new criteria. From this viewpoint, if a civilisation is identified as a system of admissible behavioural rules, then property-right regimes and outcomes reflect both such rules and the environmental features (including geography) with which they interact.

Now, during the history of man the sources of rules legitimacy have been either external or internal to human kind<sup>21</sup>. In the former case the norms for social behaviour (morality) come from one or more divinities, who dictate the rules of the game. The power of a secular ruler is then legitimate as long as he proves that he has actually been designated by God and that he has not betrayed the implicit pact of obedience to comply with and apply divine rule (call it good government). As we know, this structure of legitimacy provides an effective constraint upon the abuse of power and is therefore a powerful contribution to social stability, as long as divine designation remains unquestioned and the pact of obedience is clearly specified and understood by the population.

The other source of legitimacy is man as such, as the Enlightenment has asserted. In this case the bond between religion and morality is de facto eliminated, and therefore that between religion and power (De Jouvenel [1945] 1993). Man himself defines the relevant rules, which may be the outcome of a more or less well conceived social order (as the constructivist legacy of the French Enlightenment would suggest) or the outcome of spontaneous interactions among free man (as the Scottish Enlightenment has claimed). Under both circumstances, however, the ruler no longer is the secular executor of divine will, but either the interpreter and executor of the alleged social contract that underlies the agreed-upon enlightened social design; or the protector of individual freedom.

It has been previously argued that a winning civilisation, i.e. a society that survives its inevitable inner tensions<sup>22</sup> and provides opportunity for economic progress, is one where the principle of self-responsibility prevails and productive entrepreneurial talents are rewarded by those who benefit from them. By taking account the various points suggested so far, the key questions that development economics should then address are thus the following. Can a supposedly optimally-designed society satisfy the two requirements just mentioned? If not, what system of legitimacy does? Where do

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<sup>21</sup> One area of potential ambiguity must be conceded, though. That applies to the case of animism, whereby one cannot claim that man is his own master except for the rules that discipline his interaction with other men. Nor can one claim that these rules come from one or more clearly identified divine authorities.

<sup>22</sup> Tensions can be explained by the fact that individuals may share the same broad values, apply them in different ways, so that temptations to deviate from recognised ethical standards are sometimes hard to resist.

undeveloped economies currently stand? And what are the chances for them to move from one system to the other? Even if instructive, lack of space does not allow close scrutiny of past historical experiences so as to shed light on the elements that shaped successful dynamics both across and within civilisations. The last part of this paper will however attempt to highlight some elements concerning today's undeveloped economies.

### **Back to the Economics of Development – Culture or Rules?**

The search for an optimally-designed property-right structure is indeed the core of state-of-the-art development economics, as taught in the classroom and presumably applied by government and international agencies, including the International Monetary Fund and the World Bank.

#### *Constructivism once again*

By extending the discussion proposed in the previous paragraphs, it is manifest that constructivism per se cannot solve the problem of slow economic progress. As a matter of fact, it can make it worse. For the very acceptance of a constructivist approach implies that both the design of the rules and their subsequent interpretations are subject to human discretion. And that the decision about those in charge and about how far their discretion should go is to be defined through the political process. For understandable reasons the mechanism that is likely to prevail is the one which maximises consensus (democracy). Not surprisingly, the rule-making game is then a mix of rent-seeking interests and redistributive pressures<sup>23</sup>. Such an environment is hardly conducive to growth.

This leads to the essence of the poverty trap, which of course has little or nothing to do with the so-called savings and human-capital gaps. As has been mentioned earlier on, when people with little to lose compete for power, they also have

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<sup>23</sup> Indeed, this problem was not totally overlooked even by some authors of the French Enlightenment, such as Rousseau, who actually claimed that the people at large are not wise enough to decide, so that a democratic voting procedure would have been inappropriate. The lessons was well taken by the leaders of the French Revolution, who therefore felt authorised to interpret the needs of the people whatever their desires might have been, and actually introduced oligarchic rule first, tyranny later. Especially in the West, XXth century politicians chose to ignore that lesson.

little restraint in transforming peaceful confrontation into violent conflicts. Such conflicts are often described as clashes among different religious or ethnic groups. These explanations certainly contain some truth, but they are only part of the story. For the real question remains the acquisition of unrestricted power, an area where self-responsibility, entrepreneurship and concern for property-right enforcement play a very modest role, if at all. Indeed, when it comes to the race to power among competing pressure groups, teamwork and loyalty to the coalition weigh more than responsibility and accountability. And those who better than others succeed in relieving people from individual responsibilities and in lieu promise redistribution through rent-seeking positions (sometimes disguised as ‘social rights’) acquire group leadership. Furthermore, since the rewards to unproductive entrepreneurs are greater than those obtained by means of productive entrepreneurship, it is hardly surprising that making money by using talent is seldom regarded as an honourable activity. For envy often leads people to associate somebody else’s success with unfair behaviour, even when that is not the case.

Under these circumstances private property rights are hardly protected and contract scarcely enforced. But that account can be no basis for policy, for it amounts to arguing that constructivism has failed because it has not been enforced or because there was not enough of it. Once one accepts the constructivist criterion, the possibility of introducing rule of law in a developing country is seriously compromised. The heart of the matter is that there is no demand for a better property rights structure and most feel justified in adjusting to the prevailing moral environment, including rent-seeking malpractices. To this point is devoted the final paragraph of this article.

### *Legitimacy and development*

According to the argument developed so far, the so-called poverty trap of an undeveloped economy is in fact a legitimacy gap, whereby any kind of political leader or élite develops a short-term horizon and feels no restraints in his/her race to power. In the end, in these countries formal democracies and formal autocracies do not differ much. Contrary to what has been argued by some institutional economists (such as Olson, 1993), a modern democracy is not necessarily more encompassing than an

autocratic regime<sup>24</sup>, for both regimes suffer from the shortcomings of little accountability and from the need to redistribute resources to clienteles.

It is therefore not surprising that public choice scholars as well as institutional authors are somewhat uncomfortable in explaining the birth of an autocracy and then the transition from autocracy to democracy. Indeed, even a cursory look at the literature shows that in order to escape determinism they have to fall back on residual solutions<sup>25</sup> or accidents (exogenous shocks), which is of course hardly satisfactory.

History shows that growth in the West took place when the issue was not about moving from an institutional environment to another, but from an ideological system to another, i.e. from one set of sources for legitimacy to another. At the beginning, transition was founded on a unique source of divine legitimacy (the Emperor) to multiple and often times competing representatives of the divine will – the monarch, the aristocracy, the Church. In some cases an oligarchy of learned men also entered the field, thereby advocating the right of the individual to assess the actual meaning of religious obedience, its political consequences and thus enforcing rulers' accountability (Humanism). Contrary - say - to the Islamic world<sup>26</sup>, this evolution took place in the West during the Middle Ages. Sometimes it was successful (Northern Italy, the Low Countries), sometimes it almost failed (Spain) or brought about mixed results (France, England).

Later on two other key passages took place, under the influence of French Enlightenment (and of the French Revolution) and of Romantic Darwinism (leading to the First World War). These caused a reduction in political competition and encouraged constructivism; but they took place at a moment when the power of economic progress had already been unleashed, living standards were already high enough to discourage systematic violent confrontation within each country. More important, the winning coalitions had already established and legitimised themselves as guarantors of enough redistribution to ensure the so-called social peace.

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<sup>24</sup> The very fact that growth seems to independent of the political regime supports this statement. See for instance Gwartney, Lawson and Holcombe (1999) for a survey of the literature.

<sup>25</sup> For instance, Olson (1993) posits that democracy comes to the surface when competing autocrats face stalemate after prolonged fighting and eventually choose a cooperative solution.

<sup>26</sup> See for instance Labohm (2003).

Unfortunately, none of this can be claimed for today's undeveloped world, where the pursuit of rents and policy-making power is assuaged neither by shared moral standard (legitimacy), nor by consolidated coalitions looking for consensus, even if at the expense of a suitable property right regime and thus growth. Hence, there is no particular reason to believe that the introduction of Western constructivist ideologies will generate much economic progress. It is certainly true that the Western 'rule of law' and property right enforcement systems are highly correlated with high incomes. But Western wealth has been created thanks to an ideological environment that is no longer there. And nowadays much of Western governance structures are designed to stabilise the distribution of that wealth among interest groups and meet both competitive pressures and envy; rather than to enhance the creation of new sources of prosperity. By inducing developing countries to accept such governance structures, Western well-meaning social engineers would induce the undeveloped world to concentrate on - and fight for - fragments of income, with little concern for the creation of new wealth. Under such circumstances, a heap of desirable constitutions would assign and define more or less questionable rights over very little property.

It thus appears that the best chances for the protection and enforcement of property rights are enjoyed by those countries where an established autocracy draws its legitimacy from its ability to abstain from excessive intervention and to restore dignity to productive entrepreneurship. Only later will this lead to a demand for formal property-right structures and more effective enforcement. Surely, sooner or later, pressure for redistribution will also rise and lead to possible political crises, especially if growth loses momentum. If pressure comes too early, property rights would be violated and economic progress would come to a standstill, if class or ethnic ideologies prevail and large groups have little to lose from violent confrontation. Otherwise, growth will slow down quietly and the catching-up dynamics will come to an end.

Surely, the Western model may also be rejected, as it appears to be the case in many European countries, where youth are rapidly losing interest in political engineering and, indeed, in politics as a whole. If so, there are reasons for hope. Although the illusion of the welfare state still has many adepts - even among the young - the wind of globalisation may soon prove too hard to resist. It might encourage

individuals to go back to the liberal cornerstones of Middle-Age Western Europe and appreciate the virtues of holding on to the (subjectivist) principles of the natural order.



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