

# Review of: "Liberalism Caused the Great Enrichment"

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## A Review of "Liberalism Caused the Great Enrichment" by Deirdre N. McCloskey

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For *Qeios*.

### 1. Introduction

Deidre McCloskey is an inspiring thinker and writer. She typically pushes the boundaries of enquiry, and she is not afraid to challenge orthodoxy. She was a huge stimulation for me when I wrote my *Conceptualizing Capitalism* (2015) and *The Wealth of a Nation* (2023, in press). So much so, that my 2023 book is dedicated in part to her. There is much in her article on "Liberalism caused the Great Enrichment" with which I agree. I concur with her emphasis on ideas, but as I try to explain below, ideas alone are not enough.

I also share her stress on the role of liberal ideas in energizing and enabling modern high levels of prosperity. China has been hugely successful as a non-liberal country, but its GDP per capita is still well behind the leading developed countries. In 2020, Chinese GDP per capita (by one PPP measure) was estimated at 27 per cent of the level in the US (Central Intelligence Agency, 2022). China has made impressive progress, but it still has a long way to go.

No country in history has reached a level of GDP per capita (purchasing power parity) of around \$40,000 (at 2020 prices) without substantia private enterprise and competitive markets. Few countries have reached this \$40,000 level without representative democracy and the rule of law. (Possible exceptions include some oil-rich countries.) Although Deidre and I promote different versions of liberalism (I am closer to Thomas Paine, John Stuart Mill, T. H. Green and John A. Hobson), there is significant overlap (Hodgson, 2021; McCloskey, 2019). We both agree that liberalism matters.

But I at several analytical points I differ. These concern the role of ideas, the meanings of capital and capitalism, and her over-hasty dismissal of the role of institutions. The remainder of this review is devoted to these points.

### 2. Capital and capitalism

Deidre writes in this essay: "The agent in economic models does not have agency." I am in full agreement with her on this.

The active, thinking, interpretative, problem-solving, innovative agent is absent in much of economic theory. It is lacking in models that descend from functions like  $Q = f(K, L)$ . This production function and its descendants, including endogenous growth theory, are all about physical stuff and the physical force of labor that moves and transforms that physical stuff. Ideas are absent. Humans are diminished. Social relations and institutions sit awkwardly alongside, often covert. Deirdre is right to point all this out.

But I believe that Deirdre is still partly guided by the physicalist framework of thinking that gave rise to  $Q = f(K, L)$ . Consider the meaning of the word *capital*. It has been well established elsewhere that its meaning changed with Adam Smith (Cannan, 2020; Hodgson, 2014, 2015). Smith had many good points, but this was a backward step.

Even today, in everyday business and accounting usage, *capital* means a sum of money to be invested, or already invested, in material or immaterial assets. *Capital* is a monetary measure of alienable property. In the real world, *capital* is not stuff. But most economists differ. Inspired by the triumph of Newtonian science and the growing use of machines, Smith changed the meaning of *capital* to the things themselves. *Capital* became stuff. This decisive shift in the meaning of *capital*, from a monetary evaluation to a physical asset, has muddled social scientists ever since. It is found in the confusion of *capital goods* with *finance capital* and in the mistaken treatment of finance as a “factor of production”. These confusions are sadly still commonplace in economics, economic history, sociology and elsewhere. Yet in the real world of business and accounting, *capital* still means money or the money value of alienable assets.

A minority of economists, including Carl Menger and Joseph Schumpeter, have pointed to the error of treating capital as stuff. But Deirdre, I’m afraid to say, still commits this sin. Elsewhere she depicted capital accumulation as “piling brick on brick” (McCloskey, 2016, p. 93). In the present essay she writes that “the C-word makes the erroneous suggestion that the modern world was initiated by and keeps growing by piling brick upon brick, bachelor’s degree upon bachelor’s degree.” This “Piling up physical or human capital” adds humans as movers or transformers of the physical stuff. We are back to  $Q = f(K, L)$ . Deirdre wrongly perceives capital as physical forces and stuff, thus replicating the Smithian error that has disrupted economics for over 250 years. She promotes ‘humanomics’, but has not yet made capital a human invention.

This physicalist view of capital lies behind her use of the word capitalism. If capital is stuff, and capitalism involves its accumulation, then capitalism has existed since our primate ancestors invented tools, much earlier than “in Mesopotamia in 2000 BCE” (as she puts it), and ever since. It all depends on the definition of capitalism. If capitalism means the accumulation of tools and other stuff, then it has existed for millions of years. The label does not serve any discernible use, and it might as well be abandoned.

But others define capitalism differently. For Marx, an essential feature of “the capitalist mode of production” was wages laborers, working for profit-seeking owners of the means of production. Capitalism is no longer eternal. It starts with the widespread adoption of wage labor. This began in England in the late fourteenth century, a bit earlier than Marx reported. But it was a major transformation. Serfdom was prevalent before the Black Death of 1348. Capitalism becomes a historically specific category.

Schumpeter, by contrast, rejected the view of capital as stuff. And he saw the rise of financial markets and other

institutions as an essential feature of capitalism. Accordingly, he dated the rise of capitalism to the sixteenth century. Elsewhere Deirdre critiqued Schumpeter's claim, but in doing so she slipped unconsciously from finance capital to capital goods, writing not of finance but of "piling brick on brick" (McCloskey, 2010, pp. 132-9; 2016, p. 93). But Schumpeter insisted that capital was not goods but money.

Challenging the idea that finance is recent, Deirdre wrote: "Finance and saving and investment cannot have been crucial" for modern development, as places such as Florence, Athens or Beijing "would have innovated us into the modern world" (McCloskey, 2010, p. 138). If finance capital is clearly distinguished from capital goods – which sadly Deirdre fails to do – then again, we have a very different story. Even if Deirdre's claims about finance in ancient Athens etc. are correct, and capitalism is defined in terms of finance capital, then capitalism has existed for only about three thousand years, not millions, as the physicalist view of capital and capitalism would imply.

Elsewhere I argue that while ancient Athens etc. had money and banks, several features of modern financial systems were absent, and they did not become well developed in England until the seventeenth century. This stress on the distinctive features and dimensions of modern finance is found in the work of other scholars (Goldsmith, 1987; Hodgson, 2023; Neal, 2015).

In sum, Deirdre is wrong to exclusively associate capital with physical stuff, and this is the basis of her questionable dismissal of the word *capitalism*. If *capitalism* means a market economy dominated by financial institutions, then we have a different story. We can argue when these first appeared. But, whatever the outcome of that discussion, capitalism would not have existed for more than a small fraction of human history. Capitalism is a historically specific phenomenon. Capital is not an eternal verity of human existence.

### 3. Ideas and institutions

Deirdre writes in the essay under review: "Any innovation—mechanical, biological, institutional, scientific, artistic, personal – begins of course as a new idea in a liberated human mind. The point is obvious." OK. But "begins" is the weasel word here. The words "of course" might hurry us on. But we need to stop and think. Is it really THE beginning? Does Deirdre imply an uncaused cause? Or are ideas themselves caused? Isn't everything in an endless chain of cause and effect? Doesn't every event – including the birth or adoption of an idea – have a cause?

Elsewhere Deirdre gave reasons for making ideas primary. She pointed out that "there are literally an infinite number of necessary conditions" for any event "admittedly more and more remote." But if this were an excuse for abandoning causal explanation then all science would be redundant. She also narrowed the possible "causes" to "the mental states of human individuals". Indeed, thoughts that motivate actions are crucial. She went further, to regard mental states as the primary causes. Other factors, including institutions, were seen as "intermediate" (McCloskey and Silvestri, 2021, pp. 725-6). With this restrictive, mind-centered notion of *cause*, it is understandable why ideas are highlighted as the drivers of the Great Enrichment. But even if we accept this very limited understanding of a *cause*, institutions and other factors can still be part of the *explanation* of economic development.

If I am constrained by an institutional rule, then that rule is part of the explanation of my behavior. With Deirdre's highly restricted sense of *cause*, it may not *cause* my behavior. But it is a necessary part of its explanation. Institutions include mechanisms of power. These result in some ideas being ignored and others being followed. Institutions and power help to explain the selection, rise and spread of ideas.

Liberalism has had an important role in economic development. But we must explain the rise, spread and hold of liberal ideas. Some liberal notions were expressed in ancient Rome. But they did not spread widely. Liberalism had to wait until modern times for a context in which it could begin to flourish. Science and technology were important too, and these also required institutional underpinnings.

In the article under review and elsewhere, Deirdre's dismissal of institutions centers on the "neo-institutionalism" of Douglass North and others. With Barry Weingast, North saw the English economic take-off as stemming in part from "secure property rights" established by the Glorious Revolution of 1688 (North and Weingast, 1989). I agree with Deirdre and several other critics that this argument does not square with the facts (Hoppit, 2011; Ogilvie and Carus, 2014; Hodgson, 2017, 2023). The evidence clearly shows that landed and other property rights were mostly secure from the thirteenth century.

But Deirdre, Douglass and Barry all neglect the different legal types of property right (Honoré, 1961) and their implications for the developmental story. Prior to 1600 much English land was tied up with legal entails that disallowed its sale and restricted its use as collateral for borrowing. Mortgaging land was rare before 1600. Major reforms in mortgage laws after 1670 were necessary to facilitate mortgaging. It is abundantly clear from the evidence that through enclosures and the gradual undoing of entails, more land was made alienable and usable as collateral. These changes were particularly marked in the eighteenth century (Bogart and Richardson, 2011).

Deirdre shares with Douglass and Barry a neglect of different kinds of property right and their importance for institutional and economic development. Property rights had to change in character to enable mortgaging and other financial developments that all played a part in the Great Enrichment. Financial institutions were important, as Alex Trew and several others have shown (Trew, 2010; Hodgson, 2023).

#### 4. Conclusion

I have noted Deirdre's capacity to stimulate ideas and to question the received wisdom. My criticism is that she is still too orthodox in her view of *capital* and in the version of institutionalism that she chooses to critique. But my disappointments with parts of her argument should be no bar to the publication and widespread circulation of her article.

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