And Some Amiable Notes from Me Too

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It was great to debate with Deirdre yesterday. Talking to her is always a pleasure and learning experience. I also much appreciated the questions from the audience.

Deirdre and I agree on many things. We are both in that exiled minority of heretical economists who dare to be critical of Max U. Our recent conversation reveals points of further agreement, and some of disagreement.

We agree: institutions are important

In her talk and in her *Amiable Notes*, Deirdre admitted that institutions are important in helping to explain the Great Enrichment. This is not quite the impression given by the subtitle of her book *Bourgeois Dignity: How Ideas, not Capital or Institutions, Enriched the World* (McCloskey, 2016).

She explains in her talk and notes that institutions "are not causal the way human ideas are indeed causal". Instead they are "intermediate". But ideas too are "intermediate". They too are caused. They too have effects. They too are part of a great chain of causation, going back in evolutionary time.

Deirdre insists that "we need to acknowledge human action". I fully agree. That's why ideas, moods, emotions, habits, instincts, social relations, moral sentiments, sympathy, religion and ideology all matter.

But Deirdre seems to want to go further and make individual human agents the *only* causes. This is tricky because tornados, plagues, earthquakes, volcanic eruptions and rainfall all have socio-economic effects. Are they not causes? We are getting into philosophical deep water. For the sake of argument, let's say that such acts of God are not causes.

Then, on this assumption, it is clear that neither institutions nor capital are causes. End of argument? No. The key issue is whether they are part of the *explanation.* The Black Death is part of the explanation of the decline of serfdom in England. Institutions are part of the explanation of the Great Enrichment.

Deirdre and I agree that institutions are not simply constraints. She wrote in *Bourgeois Dignity:* "Institutions do not merely constrain human behavior, giving prices to which people have an incentive to respond. They express humanness, giving it meaning."

But they do in part act as constraints. If I am constrained by an institutional rule, then that rule is part of the explanation of my behaviour. It may not "cause" my behaviour, in Deirdre's sense of "cause". But it is part of the explanation.

Institutions enable and constrain human action. Institutions include mechanisms of power. These result in some ideas being ignored and others being copied. They help to explain the selection, rise and spread of ideas. Ideas and rhetoric are vital, but their origins and spread among a population must also be explained.

Was it liberalism? In part yes. But we have to explain the rise and spread of these ideas. Some liberal ideas were expressed in ancient Rome. But they did not take hold. We had to wait until the seventeenth century. Why? And as I said, science and technology were important too, and these too required institutional underpinnings.

Deirdre makes an important argument about the scale of the Great Enrichment. It was massive and unprecedented. She contrasts this innovation and growth with the static and conservative nature of most institutions. But I don't see an insurmountable problem here. My version of the MS Word is a static computer program. But that does not make its outputs of achievements static. Napoleon regularised the drive-on-the-right rule on roads, when they carried a few people each day. Today, millions of people follow the drive-on-the-right rule. The rule is static, but its use has increased dramatically.

On capital and finance

Following Schumpeter and others, I think that financial institutions are central to the explanation of the Great Enrichment. I argue this in my *Conceptualizing Capitalism* (2015).

Noting the ancient roots of banking, McCloskey (*Bourgeois Dignity* 2010: 138) concluded: "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." This overlooks the primitive state of banking, by modern standards, in ancient China, ancient Greece and even medieval Florence. The economic historian Larry Neal (2015) saw the beginnings of "modern finance", with stable currencies and long-term public debt, in Genoa in the fifteenth century. Florence got off to an impressive start as well. But political fragmentation and wars prevented the full development of a modern financial system in medieval Italy. The baton was passed to the Dutch, then the British.

Finance-driven economies build on both experience and legislation to establish contractual rules, concepts and templates to deal with complex financial obligations. Modern banking systems also depend on central banks and markets for debt. Created in 1668, the Swedish *Riksbank* was the world's first central bank. The Bank of England followed in 1694.

Deirdre (*Bourgeois Equality,* 2016: 93) sees *capitalism* as the accumulation of capital goods, or "piling brick on brick" as she put it. This confuses finance capital with capital goods. It is an ancient Smithian error that has deceived economists since 1776. It is finance that is central to capitalism.

As Schumpeter (*Business Cycles,* 1939: 223) explained, "capitalism is that form of private property economy in which innovations are carried out by means of borrowed money, which in general … implies credit creation."

It was a very fruitful discussion. Let's have more.